

**BLAS GUTIERREZ, AND MARIA MORALES, PETITIONERS, VS.
HONORABLE COURT OF TAX APPEALS, AND THE COLLECTOR OF
INTERNAL REVENUE, RESPONDENTS.***G. R. Nos. L-9738 & L-9771. May 31, 1957*

Ponente: FELIX, J.

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Maria Morales was the registered owner of an agricultural land designated as Lot No. 724-C of the cadastral survey of Mabalacat, Pampanga. The Republic of the Philippines, at the request of the U.S. Government and pursuant to the terms of the Military Bases Agreement of March 14, 1947, instituted condemnation proceedings in the Court of First Instance of Pampanga, docketed as Civil Case No. 148, for the purpose of expropriating the lands owned by Man a Morales and others needed for the expansion of the Clark Field Air Base, which, project is necessary for the mutual protection and defense of the Philippines and the United States. Blas Gutierrez was also made a party defendant in said Civil Case No. 148 for being the husband of the landowner Maria Morales. At the commencement of the action, the Republic of the Philippines, therein plaintiff, deposited with the Clerk of the Court of First Instance of Pampanga the sum of P156,960, which was provisionally fixed as the value of the lands sought to be expropriated, in order that it could take immediate possession of the same.

On January 27, 1949, upon order of the Court, the sum of P34,580 (PNB Check 721520-Exh. R) was paid by the Provincial Treasurer of Pampanga to Maria Morales out of the original deposit of P156,960 made by therein plaintiff. After due hearing, the Court of First Instance of Pampanga rendered decision dated November 29, 1949, wherein it fixed as just compensation P2,500 per hectare for some of the lots and P3,000. per hectare for the others, which values were based on the reports of the Commission on Appraisal whose members were chosen by both parties and by the Court, which took into consideration the different conditions affecting the value of the condemned properties in making their findings.

In virtue of said decision, defendant Maria Morales was to receive the amount of P94,305.75 as compensation for Lot No. 724-C which was one of the expropriated lands. But the Court disapproved defendants' claims for consequential damages considering them amply compensated by the price awarded to their said properties. In order to avoid further litigation expenses and delay inherent to an appeal, the parties entered into a compromise agreement on January 7, 1950, modifying in part the decision rendered by the Court in the sense of fixing the compensation for all the lands, without distinction, at P2,500 per hectare, which compromise agreement was approved by the Court on January 9, 1950. This reduction of the price to P2,500 per hectare did not affect Lot No. 724-C of defendant Maria Morales. Sometime in 1950, the spouses Bias Gutierrez and Maria Morales received the sum of P59,785.75 representing the balance remaining in their favor after deducting the amount of P34,580 already withdrawn from the compensation due to them.

In a notice of assessment dated January 28, 1953, the Collector of Internal Revenue demanded of the petitioners the payment of P8,481 as alleged deficiency income tax for the year 1950, inclusive of surcharges and penalties.

On March 5, 1958, counsel for petitioners sent a letter to the Collector of Internal Revenue requesting the latter to withdraw . and reconsider said assessment, contending among others, that the compensation paid to the spouses by the Government for their property was not "income derived from sale, dealing' or disposition of property" referred to by section 29 of the Tax Code and therefore not taxable; that even granting that condemnation of private properties is embraced within the meaning of the word "sale" or "dealing", the compensation received by the taxpayers must be considered as income for 1948 and not. for 1950 since the amount deposited and paid in 1948 represented more than 25 per cent of the total compensation awarded by the court; that the assessment was made after the lapse of the 3—year prescriptive period provided for in section 51-(d) of the Tax Code; that the compensation in question should be exempted from taxation by reason of the provision of section 29 (6)-6 of the Tax Code; that the spouses Bias Gutierrez and Maria Morales did not realize any profit in said transaction as there were improvements on the land already made and that the purchasing value of the peso at the time of the expropriation proceeding had depreciated if compared to the value of the pre-war peso; and that penalties should not be imposed on said spouses because granting that the assessment was correct, the omission of the compensation awarded therein was due to an honest mistake.

This request was denied by the Collector of Internal Revenue, in a letter dated April 26, 1954, refuting point by point the arguments advanced by the taxpayers. The record further shows that a warrant of distraint and levy was issued by. the Collector of Internal Revenue on the properties of Mr. & Mrs. Bias Gutierrez found in Mabalacat, Pampanga, and a notice of tax lien was duly registered with the Register of Deeds of San Fernando, Pampanga, on the same date. Counsel for the spouses then requested that the matter be referred to the Conference Staff of the Bureau of Internal Revenue for proper hearing, to which the Collector answered in a letter dated December 24, 1954, stating that the request would be granted upon compliance by the taxpayers with the requirements of Department of Finance Order No. 213, i.e., the filing of a verified petition to that effect and that one half of the total assessment should be guaranteed by a bond,' provided that the taxpayers would agree in writing to the suspension of the running" of the period of prescription.

The taxpayers then served notice that the case would be brought on appeal to the Court of Tax Appeals, which they did by filing a petition with said Court to review the assessment made by the Collector of Internal Revenue, docketed as C.T.A. Case No. 65. In that instance, it was prayed that the Court render judgment declaring that the taking of petitioners' land by the Government was not a sale or dealing in property; that the amount paid to petitioners as just compensation for their property should not be diminished by way of taxation; that said compensation was by law exempt from taxation and that the period to collect the income taxes by summary methods had prescribed ; that respondent Collector of Internal Revenue be enjoined from carrying" out further steps to collect from petitioners by summary methods the said taxes which they alleged to be erroneously assessed and for such other remedies which would serve the ends of law and justice.

The Solicitor General, in representation of the respondent Collector of Internal Revenue, tiled an answer on February 11, 1955, admitting some of the allegations of petitioners and denying some of them, and as special defenses, he advanced the contention that the Court had no jurisdiction to entertain the petition; that the profit realized by petitioners from the sale of the land in question was subject to income tax; that the full compensation received by petitioners should be included in the income received in 1950, same having been paid in 1950 by the Government; that under the Bases Agreement only residents of the United States 'are exempt from the payment of income tax in the Philippines in respects to profits derived under a contract with the U.S. Government in connection with the construction, maintenance and operation of the bases; that in the determination of the gain or loss from the sale of property acquired on or after March 1, 1913, the cost of acquisition and the selling price shall be taken into account without qualification as to the purchasing power of the currency; that the imposition of the

50 per cent surcharge was in accordance with the Tax Code; that the Collector of Internal Revenue was empowered to collect petitioners' deficiency income tax; and prayed that the petition for review be dismissed; petitioners be ordered to pay the amount of P8,481 plus the delinquency penalty of 5 per cent for late payment and monthly interest at the rate of 1 per cent from April 1, 1953, up to the date of actual payment and for such other relief that may be deemed just and equitable in the premises.

After due hearing and after the parties had filed their respective memoranda, the Court of Tax Appeals rendered decision on August 31, 1955, holding that it had jurisdiction to hear and determine the case; that the gain derived by the petitioners from the expropriation of their property constituted taxable income and as such was capital gain; and that said gain was taxable in 1950 when it was realized. It was also found by said Court that the evidence did not warrant the imposition of the 50 per cent surcharge because the petitioners acted in good faith and without intent to defraud the Government when they failed to include in their gross income the proceeds they received from the expropriated property, and, therefore, modified the assessment made by respondent, requiring petitioners to pay only the sum of P5,654. From this decision, both parties appealed to this Court and in this instance, petitioners Bias Gutierrez and Maria Morales, as appellants in G. R. No. L-9738, made the following assignments of error:

- That the Court of Tax Appeals erred in holding that, for income tax purposes, income from expropriation should be deemed as income from sale, any profit derived therefrom is subject to income tax as capital gain pursuant to the provisions of Section 37-(a)-(5) in relation to Section 29-(a) of the Tax Code;
- That the Court of Tax Appeals erred in not holding that, under the particular circumstances in which the property of the appellants was taken by the Philippine Government, the amount paid to them as just compensation is exempt from income tax pursuant to Section 29 (b)-(6) of the Tax Code;
- That the Court of Tax Appeals erred in not holding that the respondent Collector is definitely barred by the Statute of Limitations from collecting the deficiency income tax in question, whether administratively thru summary methods, or judicially thru the ordinary court procedures;
- That the Court of Tax Appeals erred in not holding that the capital gain found by the respondent Collector as have been derived by the petitioners-appellants from the expropriation of their property is merely nominal, not subject to income tax, and in not holding that the pronouncement of the court in the expropriation case in this respect is binding upon the respondent Collector of Internal Revenue; and
- That the Court of Tax Appeals erred in not pronouncing upon the pleadings of the parties that the petitioners-appellants did not derive any capital gain from the expropriation of their property.

The appeal of the respondent Collector of Internal Revenue was docketed in this Court as G- R. No. L-9771, and in this case the Solicitor General ascribed to the lower court the commission of the following error:

That the Court of Tax Appeals erred in holding that respondents, are not subject to the payment of the 50 per cent surcharge in spite of the fact that the latter's income tax return for the year 1950 is false and/or fraudulent.

The facts just narrated are not disputed and the controversy only arose from the assertion by the Collector of Internal Revenue that petitioners-appellants failed to include from their gross income, in filing their income tax return for 1950, the amount of P94,305.75 which they had received as compensation for their land taken by the Government by expropriation proceedings. It is the contention of respondent Collector of Internal Revenue that such transfer of property, for taxation purposes, is "sale" and that the income derived therefrom is taxable. The pertinent provisions of the National Internal Revenue Code applicable to the instant cases are the following:

Sec. 29. Gross Income.—(a) General definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or

from professions, vocations, trades, businesses, commerce, sales or dealings in property, whether real or personal, growing out of ownership or use of or interest in such property; also from interests, rents, dividends, securities, or the transactions of any business carried on for gain or profit, or gains, profits, and income derived from any source whatsoever.

Sec. 37. INCOME FROM SOURCES WITHIN THE PHILIPPINES.—

(a) Gross income from sources within the Philippines.—The following items of gross income shall be treated as gross income from sources within the Philippines:

* * * * *

(5) SALE OF REAL PROPERTY.— Gains, profits, and income from the sale of real property located in the Philippines;

* * * * *

There is no question that the property expropriated being located in the Philippines, compensation or income derived therefrom ordinarily has to be considered as income from sources within the Philippines and subject to the taxing jurisdiction of the Philippines. However, it is to be remembered that said property was acquired by the Government through condemnation proceedings and appellants' stand is, therefore, that same cannot be considered as sale as said acquisition was by force, there being practically no meeting of the minds between the parties. Consequently, the taxpayers contend, this kind of transfer of ownership must perforce be distinguished from sale, for the purpose of Section 29-(a) of the Tax Code. But the authorities in the United States on the matter sustain the view expressed by the Collector of Internal Revenue, for it is held that:

"The transfer of property through condemnation proceedings is a sale or exchange within the meaning of section 117 (a) of the 1936 Revenue Act and profit from the transaction constitutes capital gain"(1942. Com. Int. Revenue vs. Kiesclbach (CCA 3) VII F. (24) 359). "The taking of property by condemnation and the payment of just compensation therefore is a 'sale' or 'exchange' within the meaning of section 117 (a) of the Revenue Act of 1939, and profits from that transaction is capital gain" (David R. Brown vs. Comm., 1942, 42 BTA 139).

The proposition that income from expropriation proceedings is income from sales or exchange and therefore taxable has been likewise upheld in the case of Lapham vs. U.S. (1949, 40 AFTR 1370) and in Xneipp vs. U.S. (1849, 85 F Suppl. 902). It appears then 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 proceeds from said transaction clearly fall within the definition of gross income laid down by Section 29 of the Tax Code of the Philippines.

Petitioners-appellants also averred that granting that the compensation thus received is "income", same is exempted under Section 29-(6)-6 of the Tax Code, which reads as follows:

Sec. 29. GROSS INCOME.—

(b) EXCLUSIONS FROM GROSS INCOME.—The following items shall not be included in gross income and shall be exempt from taxation under this Title:

(6) Income exempt under treaty.—Income of any kind, to the extent required by any treaty obligation binding upon the Government of the Philippines.

The taxpayers maintain that since, at the request of the U.S. Government, the proceeding to expropriate the land in question necessary for the expansion of the Clark Field Air Base- was instituted by the Philippine Government as part of its obligation under the Military Bases Agreement, the compensation accruing therefrom must

necessarily fall under the exemption provided for by Section 29-(b)-6 of the Tax Code. We find this stand untenable, for the same Military Bases Agreement cited by appellants contains the following:

"ARTICLE XXII

"CONDEMNATION OR EXPROPRIATION

"1, Whenever it is necessary to acquire by condemnation or ex-propriation proceedings real property belonging to private persons, association, or corporations located in bases named in Annex 'A' and Annex 'B' in order to carry out the purposes of this agreement, the Philippines will institute and prosecute such condemnation proceedings in accordance with the laws of the Philippines. The United States agrees to reimburse the Philippines for all the reasonable expenses, damages, and costs thereby incurred, including the value of the property as determined by the Court. In addition, subject to mutual agreements of the two governments, the United States shall reimburse the Philippines for the reasonable costs of transportation and removal of any occupants displaced or ejected by reason of the condemnation or expropriation".

"ARTICLE XII

"INTERNAL REVENUE EXEMPTION

"(1) No member of the United States Armed Forces except Filipino citizens, serving in the Philippines in connection with the bases and residing" in the Philippines by reason only of such service, or his dependents, shall be liable to pay income tax in the Philippines except in respect of income derived from Philippine sources.

"(2) No national of the United States serving - in the Philippines in connection with the construction, maintenance, operation or defense of the bases and residing in the Philippines by reason only of such employment, or his spouse and minor children and dependent parents of either spouse, shall be liable to pay income tax in the Philippines except in respect of income derived from Philippine sources or sources other than the United States.

"(3) No person referred to in paragraphs 1 and 2 of this said Article shall be liable to pay the government or local authorities of the Philippines any poll or residence tax, or any imports or exports duties, or any other tax on personal property imported for his own use provided, that private owned vehicles shall be subject to payment of the following only: when certified as being used for military purposes by appropriate United States Authorities, the normal license plate fee; otherwise, the normal license and registration fees.

"(4) No national of the United States, or corporation organized under the laws of the United States, shall be liable to pay income tax in the Philippines in respect of any profits derived under a contract made in the United States with the government of the United States in connection with the construction, maintenance, operation and defense of the bases, or any tax in the nature of a license in respect of any service of work for the United States in connection with the construction, maintenance, operation and defense of the bases.

* * * * *

The facts brought about by the aforementioned terms of the said treaty need no further elucidation. It is unmistakable that although the condemnation or expropriation, of properties was provided for, the exemption from tax of the compensation to be paid for the expropriation of privately owned lands located in the Philippines was not given any attention, and the internal revenue exemptions specifically taken care of by said Agreement applies only to members of the U.S. Armed Forces serving in the Philippines and U.S. nationals working in these Islands in connection with the construction, maintenance, operation and defense of said bases.

Anent appellant taxpayers' allegation that the respondent Collector of Internal Revenue was barred from collecting the deficiency income tax assessment, it having been made beyond the 3-year period prescribed by section 51-(d) of the Tax Code, We have this much to say. Although it is true that by order of the Court of First Instance of Pampanga, the amount of P54,580 out of the original deposit made by the Government was withdrawn in favor of appellants on January 27, 1949, the same cannot be considered as income for said year but for 1950 when the balance of P59,785.75 was actually received. Before that date (1950), appellant taxpayers were still the

owners of their whole property that was subject of condemnation proceedings and said amount of P34,580 was not paid to, but merely deposited in court and withdrawn by them. Therefore, the payment of the value of Maria

Morales' Lot 724-C was actually made by the Republic of the Philippines in 1950 and it has to be credited as income for 1950 for it was then when title over said property passed to the Republic of the Philippines. Appellant taxpayers cannot say that the title over the property expropriated already passed to the Government when the latter was placed in possession thereof, for in condemnation proceedings, title to the land does not pass to the plaintiff until the indemnity is paid (*Calvo vs. Zandueta*, 49 Phil. 605), and notwithstanding possession acquired by the expropriator, title does not actually pass to him until payment of the amount adjudged by the Court and the registration of the judgment with the Register of Deeds (See *Visayan Refining Company vs. Camus et al.*, 40 Phil. 550; *Metropolitan Water District vs. De los Angeles*, 55 Phil. 788). Now, if said amount should have been reported as income for 1950 in the return that must have been filed on or before March 1, 1951, the assessment made by the Collector on January 28, 1958, is still within the 3-year prescriptive period provided for by Section 51-d and could, therefore, be collected either by the administrative methods of distraint and levy or by judicial action (See *Collector of Internal Revenue vs. A.P. Reyes et al.*, 100 Phil., 822; *Collector of Internal Revenue vs. Zulueta et al.*, 100 Phil., 872; and *Sambrano vs. Court of Tax Appeals et al.*, *supra*, p. 1).

As to appellant taxpayers' proposition that the profit derived by them from the expropriation of their property is merely nominal and not subject to income tax, We find Section 85 of the Tax Code illuminating. Said section reads as follows:

"Sec. 35. DETERMINATION OF GAIN OR LOSS FROM THE SALE OR OTHER DISPOSITION OF PROPERTY.—The gain derived or loss sustained from the sale or other disposition of property, real or personal, or mixed, shall be determined in accordance with the following schedule:

(a) * * * * *

"(b) In the case of property acquired on or after March first, nineteen hundred and thirteen, the cost thereof if such property was acquired by purchase or the fair market price or value as of the date of the acquisition if the same was acquired by gratuitous title.

* * *

The records show that the property in question was adjudicated to Maria Morales by order of the Court of First Instance of Pampanga on March 28, 1929, and in accordance with the aforequoted section of the National Internal Revenue Code, only the fair market price or value of the property as of the date of the acquisition thereof should be considered in determining the gain or loss sustained by the property owner when the property was disposed, without taking into account the purchasing power of the currency used in the transaction. The records placed the value of the said property at the time of its acquisition by appellant Maria Morales was P28,291.73 and it is a fact that same was compensated with P94,305.75 when it was expropriated. The resulting difference is surely a capital gain and should be correspondingly taxed.

As to the only question raised by appellant Collector of Internal Revenue in case L-9771, assailing the lower Court's order exonerating petitioners from the 50 per cent surcharge imposed on the latter, on the ground that the taxpayers' income tax return for 1950 is false and/or fraudulent, it should be noted that the Court of Tax Appeals found that the evidence did not warrant the imposition of said surcharge because the petitioners therein acted in good faith and without intent to defraud the Government.

"The question of fraud is a question of fact "which frequently requires a nicely balanced judgment to answer. All the facts and circumstances surrounding the conduct of the taxpayer's business and all the facts incident to the preparation of the alleged fraudulent return should be considered". (Mertens, *Federal Income Taxation*,

Chapter BB).

The question of fraud being a question of fact and the lower court having made the finding that "the evidence of this case does not warrant the imposition of the 50 per cent surcharge", We are constrained to refrain from giving any consideration to the question raised by the Solicitor General, for it is already settled in this jurisdiction that in passing upon petitions to review decisions of the Court of Tax Appeals, We have to confine ourselves to questions of law.

Wherefore, the decision appealed from by both parties is hereby, affirmed, without pronouncement as to costs. It is so ordered.

Paras, C. J., Montemayor, Reyes, A., Bautista, Angelo, Conception, Reyes, J. B. L., and Endencia, JJ., concur.

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