

WILLIAM LI YAO, PETITIONER, VS. COLLECTOR OF INTERNAL REVENUE, RESPONDENT.*G.R. No. L-11875. December 28, 1963*

Ponente: LABRADOR, J.

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LABRADOR, J.:

This is a petition filed by William Li Yao for the review of a decision of the Court of Tax Appeals in C.T.A. Case No. 30, entitled "William Li Yao, petitioner vs. Collector of Internal Revenue, respondent." The record discloses that petitioner is a naturalized Filipino of Chinese parents, the eldest son of a prosperous local businessman by the name of Li Chay Too, who died sometime in 1948. In 1945 petitioner organized the Li Yao & Company and made himself managing partner; from 1948 to February 1955 he was president of, and owned shares in, the Li Chay Too & Sons, Inc.; and in 1950 he organized a corporation known as the Far East Realty & Investment Co. (known as FERIN for short) of which he was also stockholder and president. Petitioner filed his income tax returns for the years 1945 to 1951, paying the following taxes:

YEAR

AMOUNT OF TAX

1945

P918.31

1946

1,393.42

1947

5,923.57

1948

700.34

1949

538.07

1950

3,837.00

1951

2,971.00

In 1948 a verification of his income tax returns for the years 1945 to 1947 was made and a deficiency income tax in the amount of P5,470.98 was assessed against him, which he paid.

In 1952 the Collector of Internal Revenue, believing that petitioner had not reported his true incomes for the previous years, appointed a team to examine his books, and on July 30, 1952 an additional assessment of P898,794.02 was made against for the years 1945 to 1951, inclusive. A second team of investigators was appointed and on June 30, 1953 this team recommended a deficiency income tax assessment of P2,722,030.33. This team employed what is known as the net worth or inventory method. A third team was appointed, headed by BIR Examiner Quesada. This team recommended an assessment of P1,505,768.54 against petitioner; the inventory method was also used in making this assessment. Demand was made for the collection of said assessment on August 10, 1954, so petitioner herein presented a petition with the Court of Tax Appeals for the review of the said assessment.

After hearing: the Court of Tax Appeals, after revising the various items contained in the assessment of BIR Examiner Quesada, made various findings of fact on the issues presented by the parties and thereafter rendered a decision in which it found that the amount of the income tax deficiency due from petitioner is P424,536.77. The resume of the assessment made in the decision of the Court of Tax Appeals is as follows:

1945

Assets admitted by parties

P41,538.50

Add assets established at trial:

Funds held in trust by father, Li Chay Too

143,910.89

Net Worth as of December 31, 1945

P185,449.39

Less Net Worth as of January 1, 1945;

Assets admitted by Parties

P500.00

Add assets proven at trial

Funds held in trust by father, Li Chay Too

159,910.89

160,410.89

Increase in net worth 1945

P25,038.50

Add non-deductible expenditures:

Personal living and family expenses

3,500.00

Net income

P28,538.50

Less personal exemptions

3,500.00

Amount subject to tax

25,038.50

Tax due thereon

1,082.31

Less tax already paid

1,111.74

No deficiency tax due

(29.43)

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1946

Assets admitted by parties

P148,326.77

Add assets established at trial:

Cash funds from loans

90,032.43

Total assets

238,359.20

Liabilities established at trial:

100,000.00

Net Worth as of December 31, 1946

P138,359.20

Less Net Worth as of January 1, 1946

185,449.39

Decrease in net worth in 1946

(P47,090.19)

Add: non-deductible expenditures

Personal living and family expenses

3,500.00

Income tax paid in previous year

918.91

Net loss

(P42,671.88)

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1947

Assets admitted by parties

P184,453.45

Add assets established at trial:

Cash funds from loans

78,036.52

Total assets

P262,489.97

Liabilities established at trial:

100,000.00

Net Worth as of December 31, 1947

P162,489.97

Less Net Worth as of January 1, 1947

138,359.20

Increase in net worth in 1947

P24,130.77

Add: non-deductible expenditures:

Personal living and family expenses

3,500.00

Income tax paid in previous year

1,393.42

Net income

P29,024.19

Less personal exemptions

3,500.00

Amount subject to tax

25,524.19

Tax due thereon

3,795.32

Less tax already paid

10,055.78

No deficiency tax due

(P6,260.46)

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1948

Assets admitted by parties

P176,933.76

Add assets established at trial:

Cash fuds from loans

50,384.93

Investments in Tan Pee Cu Yek Chim & Co.

30,000.00

Total assets

P257,318.69

Less liabilities established at trial:

100,000.00

Net Worth as of December 31, 1948

P157,318.69

Less Net Worth as of January 1, 1948

162,489.97

Decrease in net worth in 1948

(P 5,171.28)

Add: non-deductible expenditures:

Personal living and family expenses

20,000.00

Income tax paid in previous year

11,394.55

Net income

P26,223.27

Less personal exemptions

3,500.00

Amount subject to tax

P22,723.27

Tax due thereon

P3,179.11

Less tax already paid

700.00

Deficiency tax

P2,478.77

Add: 50% surcharge

1,239.38

Total tax due

P3,718.15

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1949

Assets admitted by parties

P435,405.83

Add assets established at trial:

China Banking Corporation Time Deposit

60,000.00

Investments in Tan Pee Cu Yek Chim & Co.

30,000.00

Total assets

P525,405.83

Liabilities established at trial:

163,000.00

Net Worth as of December 31, 1949

P362,405.83

Less Net Worth as of January 1, 1949

157,318.69

Increase in net worth in 1949

P205,087.14

Add: non-deductible expenditures

Personal living and family expenses

20,000.00

Income tax paid in previous year

700.34

Net income

P225,787.48

Less personal exemptions

3,500.00

Net income before deduction of inheritance

P222,287.48

Less inheritance

72,392.91

Amount subject to tax

149,894.57

Tax due thereon

47,137.82

Less tax already paid

538.07

Deficiency tax

P46,599.75

Add: 50% surcharge

23,299,.87

Total tax due

P69,899,.62

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1950

Assets admitted by parties

P842,273.50

Add assets established at trial:

Investments in Tan Pee Cu Yek Chim & Co.

30,000.00

Investments in FERIN through others

170,000.00

Race Horses

11,500.00

Total assets

1,053,773.50

Liabilities established at trial:

445,500.00

Net Worth as of December 31, 1950

608,273.50

Less Net Worth as of January 1, 1950

362,405.83

Increase in net worth in 1950

P245,868.67

Add: non-deductible expenditures

Personal living and family expenses

20,000.00

Income tax paid in previous year

538.07

Net income

266,405.74

Less personal exemptions

4,200.00

Amount subject to tax

P262,205.74

Tax due thereon

125,977.00

Less tax already paid

3,837.00

Deficiency tax

P122,140.00

Add: 50% surcharge

61,070.00

Total tax due

P183,210.00

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1951

Assets admitted by parties

P1,630,658.94

Add assets established at trial:

Investments in Tan Pee Cu Yek Chim & Co.

30,000.00

Investments in FERIN through others

200,000.00

Race Horses

11,500.00

Total assets

1,872,158.94

Liabilities established at trial:

1,040,500.00

Net Worth as of December 31, 1951

831,658.94

Less Net Worth as of January 1, 1951

608,273.50

Increase in net worth in 1951

223,385.44

Add: non-deductible expenditures

Personal living and family expenses

20,000.00

Income tax paid in previous year

3,839.00

Net income

P247,222.44

Less personal exemptions

4,800.00

Amount subject to tax

P242,422.44

Tax due thereon

P114,777.00

Less tax already paid

2,971.00

Deficiency tax

P111,806.00

Add: 50% surcharge

55,903.00

Total tax due

P167,709.00

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Summary of Tax Due

1945

None

1946

None

1947

None

1948

P 3,718.15

1949

69,899.62

1950

183,210.00

1951

167,709.00

Total Tax due

P424,536.77

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Petitioner Li Yao sought to reconsider the decision and the assessment, alleging that the sum of P5,470.98 paid by him as additional tax for the years 1945 to 1947 should be credited, against his deficiency income taxes, so that instead of P424,536.77 the sum due should be only P11,294.12, following the decision in the case of University of Santo Tomas vs. Collector of Internal Revenue, C.T.A. Case No. 10, dated June 4, 1956, in which the doctrine of equitable recoupment was applied provided the two requirements for its applicability are met. The court approved this petition for recoupment and reduced the assessment to P411,293.80.

Both petitioner and respondent appealed from the decision of the Court of Tax Appeals—petitioner's appeal is the within case, G.R. No. L-11875 and the respondent's appeal is case G.R. No. L-11861. This decision deals with Li Yao's appeal. Two principal questions are raised by petitioner Li Yao before Us, the first of which questions the validity of the net worth method of inventory used against him, and the second assails the Court of Tax Appeals refusal to grant petitioner's request that the deficiency income assessed be distributed evenly over the taxable years. We will leave these questions for the present until after we have decided the appeal raised against various items of the assessment.

The first issue relates to the disapproval of various items, claimed by petitioner to be his obligations, which are as follows:

J. Crisostomo Chavez

P100,000.00

Li Chiok Eng

50,000.00

Ong Tiao Seng

20,000.00

Li Chiu Ka

20,000.00

Li Tong Na

20,000.00

Ko Chiu Seng

10,000.00

Carlos M. Go

10,000.00

Dee Mong & Lim Sing

25,000.00

Arturo Mercado

10,000.00

Go Hoc

20,000.00

Ong Chin

30,000.00

TOTAL

P315,000.00

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The procedure adopted by the Court of Tax Appeals in passing upon the first of these alleged obligations is as follows:

"* * * that when a taxpayer claims he owes money to another for the purpose of reducing his tax liability, particularly when the Net Worth Expenditure (Inventory) Method of investigation is employed against him, his admission (claim) must be corroborated by other evidence independent of the admission itself. For example, the promissory note, if there be any, should be produced for the inspection of the Court and government counsel. The alleged creditor must be produced in Court to confirm the taxpayer's admission and to give government's counsel an opportunity to cross-examine him, unless he is dead, outside of the Philippines, or unable to testify for one reason or another. If the taxpayer is in business, his books as required of him by the National Internal Revenue Code should be produced showing the corresponding entry or entries of his alleged liabilities. If for one reason or another the alleged creditor is not available as a witness, his financial capacity to extend the loan should at least be established."

Attacking the above procedure counsel for petitioner argues that in the inventory method the burden of proof lies with the Government; that the taxpayer completes his obligation if he furnishes the lead by presenting the evidence of the obligation, and it is thereafter incumbent upon the Government to follow the lead to determine if the alleged liabilities actually or really existed.

We find no merit or sense in the above contention. The taxpayer has the means of proving the existence of the obligation and it is he that must produce such proof. The procedure followed by the Court of Tax Appeals is that laid down by the rules on evidence; that is, that the taxpayer who alleges that an obligation still exists must prove the existence thereof by preponderance of evidence. This rule is not only a legal one. In the nature of things, the obligor or taxpayer has the means of proving that the obligation does not exist or has been paid; the Government collecting the tax cannot be expected to find the evidence itself, because it is natural that the taxpayer would try to suppress such evidence as may prove that the obligation still exists. The court below ruled, in relation to the obligation or the supposed loan given by Crisostomo Chavez, as follows:

"Although this loan is evidenced by a duplicate promissory note, Exhibit JJJJ, we find the explanation of petitioner regarding the reproduction of the original note marked Exhibit 55-A from which Exhibit JJJJ was taken, to be highly fantastic. This alleged creditor was seen by the Court on several occasions loitering in the Court premises during the early stages of the trial of this case. However, when his turn came to testify as

witness for the respondent, he could not be served with a summons. He was cited by respondent's counsel precisely to confirm or repudiate the contents of an affidavit which he executed dated July 6, 1955 denying having made such a loan. Considering the past criminal record of this alleged creditor, his failure to testify before "this Court upon being cited to do so and the explanation of petitioner regarding the two controversial promissory notes, Exhlbits'55-A and JJJJ, which we believe to be much too strained and fantastic, we cannot give credit to the alleged liability of petitioner."

We agree with the court below; the supposed duplicate of the promissory note could well have been fabricated. "Furthermore, the supposed creditor had denied the existence of the loan in an affidavit and the taxpayer failed to produce him in evidence. Lastly the taxpayer suppressed the evidence to show that the obligation still exists and if he did so it is because the same would be unfavorable to his claim.

In connection with the loans of Ong Tiao Seng for P20,000.00, Li Chiu Ka for P20,000.00, Li Tong Na for P20,000.00, Ko Chiu Seng for P10,000.00, Carlos M. Go for P10,000.00 and Lim Siong for P25,000.00, We also agree with the court below that as petitioner had not presented the supposed creditors to confirm the existence of the loans, and no explanation had been given for such failure to present them, the existence of these loans cannot be considered as proved. The petitioner suppressed evidence which should favor him, and his suppression of such evidence proves that said evidence would be unfavorable to him if produced. As to the other loans that had been disapproved for the same reason, We find the-ruling of the court below correct.

One of the items subject of the appeal is the P30,000.00 investment in the Tan Pee, Cu Yek Chim & Co., Inc.. The said amount represents shares of stocks issued in the name of Li Yao, petitioner now contending that Tan Pee transferred the shares to Li Yao in 1948 as he felt ill and was in danger of death, and that when ha recovered in the year 1952 he decided to recall the shares and so requested Li Yao to endorse the certificates of stock back to Mm, which Li Yao did. Thereafter the shares were again placed in the name of Tan Pee. After analyzing the evidence 'Submitted to support the claim Of petitioner that Tan Pee did not intend ultimately to transfer his stocks to his son-in-law Li Yao, the court below declared that the explanation was not sufficient to refute the presumption that the transfer of said stocks was made a valid consideration, in the ordinary course of business, so that it considered the item an unreported asset of petitioner for the years 1948 to 1951. After reading the arguments presented by petitioner and considering that the witnesses for petitioner herein are his father-in-law and his wife and their testimonies failed to convince the judges of the court below, this Court finds no potent reason why the findings of the court below that heard the evidence should be disturbed.

Another item subject of the appeal is the amount of P60,000.00 deposited with the China Banking Corporation in the name of petitioner as of the end of the year 1949. Petitioner claims that one by the name of James Li, a friend of his, came to the Philippines from Hongkong in 1949 bringing with him \$30,000.0 in cash which he intended to invest in the local textile business, so petitioner alleges he deposited this sum with the China Banking Corporation in his name; that the sum was withdrawn in 1949 upon instruction of James Li and delivered to an emissary of the later by the name of Chen Heng. As the supposed owner of the fund, James Li, was not presented to corroborate petitioner's claim that he owned the money, nor any other circumstances proved to corroborate petitioner's explanation, the court below held that the evidence was insufficient and declared the sum as an asset of the petitioner. We also find no reason for disturbing the conclusion of fact and of law made by the court below. It is strange that no evidence of any kind was ever presented to corroborate the story that the sum belonged to petitioner's friend James Li, no written or testimonial evidence was also presented to prove that the amount, after it was withdrawn from the bank, was actually sent to the supposed owner. Counsel for petitioner contends that there is no prima facie presumption in favor of the correctness of the assessment made by the respondent. This is true, but the question now involved is not the correctness of the assessment but whether or not the amount of P60,000.00 deposited with the China Banking Corporation belongs to Li Yao, petitioner herein. There being no

credible evidence presented that the said amount belongs to James Li and not to Li Yao, then the only reasonable inference is that the money must belong to petitioner. The Court of Tax Appeals therefore correctly included it among the assets of the petitioner.

The next items also disallowed by the Court of Tax Appeals are the amount of P100,000.00 each, belonging to taxpayers Vicente Duazo and Delfin Fulay. The findings of the Court of Tax Appeals on these items are as follows:

"Of the five, Gloria Pineda and Delfin Fulay are the two persona upon whom suspicion could rest because of their close association with petitioner. As we have said, Gloria Pineda is the private secretary and accountant of petitioner and Delfin Fulay is his driver and bodyguard. However, with respect to Gloria Pineda who is single, her income tax returns Exhibits 68, 69, 60, 61 and 62 for 1946 to 1951, inclusive, show that she had a total net income of P25,299.50 during those years. From these returns, it is quite apparent that the investment of P25,000.00 attributed to her in 1950 which was increased to P40,000.00 in 1951 is not far beyond her reach. The relationship of employer and employee between petitioner and Gloria Pineda cannot be considered, therefore, as a decisive factor in determining whether she could well afford to invest P40,000.00 in the corporation headed by her employer.

"The case of Delfin Fulay, who is admittedly a bodyguard and driver of petitioner, is quite different. The books of FERIN show that Delfin Fulay invested P85,000.00 in said corporation in 1950, which he increased to P100,000.00 in 1961. His income tax return, for the years 1949, Exhibit 66, and his return for 1951, Exhibit 67, show that he had a total net income of only P8,500.00 during "those two years. Could it be possible for a mere hireling like Delfin Fulay, with such a moderate income, to have invested such an enormous amount as P100,00.00 in FERIN? The investment of Fulay in FEIUN is so highly disproportionate to his income that we find it impossible to believe the investment to be his own. And if the investment did not come from his own personal funds with his meager salary as driver and bodyguard, from who else could it have come but petitioner, considering the latter's admission that he purposely saw to it that the incorporators of FERIN were his close friends and persons whom, he could trust. From all appearances, the petitioner could not have chosen a person more trustworthy than Delfin Fulay, the "Man Friday" entrusted with the protection of his life and limb.

"The case of Vicente Duazo, who is admittedly a body guard and driver of petitioner's mother would seem at first blush to be entirely different from that of Delfin Fulay as far as relationship with petitioner is concerned. It appears from the evidence for the respondent that Vicente Duazo declared a net income in his return for 1948, Exhibit 63, the amount of P2,345.00; for 1949, Exhibit 64, the amount of P1,640.00 and for 1950, Exhibit 65, the amount of P3,480.00 or a total of P7,465.00. His investment in FERIN in 1950 was P854,000.00 and in 1951 it was increased to P100,000.00. It will be noted that the net income of Vicente Duazo for, three years (1948, 1949, 1950) is much less than that of Delfin Fulay for two years (1949, 1951). Yet, far from being just a mere coincidence, they invested P25,000.00 each in FERIN on August 25, 1950. * * * This striking similarity in the amounts invested at the same time, let alone the disparity in the amounts of their respective incomes, has led us to the conclusion that the investments of these two persons in said corporation came from only one source. And the evidence on record indubitably point to petitioner as the source considering his admission that after the death, of his father, he was entrusted "with the business affairs of his family he being the eldest son and favorite of the deceased."

We find no flaw in the facts and in the conclusion arrived at that the two supposed stockholders in FERIN, Duazo and Fulay, are mere dummies and said facts and conclusion are hereby affirmed.

The last item questioned by petitioner is the sum of P30,000.00 alleged to be his obligation to one Ong Chiu. To support petitioner's claim is a copy of a complaint in court against petitioner for the amount. Respondent found one Benjamin Ong Chiu, who was presented by respondent to show that he had no claim or had filed no such

action against petitioner for P30,000.00. Petitioner claimed at the trial that his creditor is not the one that respondent presented at the trial, but petitioner did not present the one whom he claims to be the real creditor. Assuming—for the sake of argument that the one presented by respondent is not the real creditor, why did not petitioner present the supposed real creditor? If there are nine Ong Chiu's well may he have conceived of presenting fictitious action in court in the name of one of them. The case is the same as the other cases above explained—one where petitioner has failed to present corroborative evidence, or the real creditor, to prove the existence of the debt in dispute. Failure to adduce the proof required, the petitioner's own testimony may not be held sufficient in law to prove his claim of the existence of the obligation.

We next come to the question of the use of the inventory method in assessing the income taxes due from petitioner. The use of the inventory method is authorized under Section 15 of the National Internal Revenue Code (Com. Act No. 466), as amended, which authorizes the Collector of Internal Revenue to assess taxes due a taxpayer from any other available fact or evidence. If a taxpayer commits a violation of the law, hiding his income to evade payment of taxes, the Government must be permitted to resort to all evidence or, sources available, to determine his said income, so that the tax may be collected for public purposes. "There is and there should be a presumption of regularity accorded this action of the Collector of Internal Revenue in assessing the tax on the best evidence obtainable, otherwise it would be impossible to assess taxes due from a dishonest taxpayer.

This form of assessment has also been adopted by the Collector of Internal Revenue with the approval of this Court in three cases, *Perez vs. Collector*, G.R. No. L-10507, May 30, 1958; *Collector vs. A.P. Reyes*, G.R. Nos. L-11534 & L-11558 Nov. 25, 1958; and *Avelino vs. Collector*, G.R. No. L-17715, July 31, 1963. In the case at bar the existence of assets or properties appearing in the name of the taxpayer or in the name of his dummies or friends, without the taxpayer being able to give a definite reasonable explanation for their existence justifies the Court of Tax Appeals and this Court to resort to the inventory method of assessment, such being necessary and at the same time just and equitable.

The last important legal question raised is petitioner's claim that the unreported incomes which appeared during the last years of the period of assessment should not be considered as having been earned during the years in which said incomes appeared, but should be spread throughout the whole period covered by the assessment, that is, from 1945. to 1951. As authority for this claim the case of *U.S. vs. Ridley*, 120 Fed. Supp. 530 is cited. In the said case Claude Ridley was assessed for the years 1942 through 1951, including taxes, penalties and interest amounting to \$106,674.37. The spouses Claude Ridley were a frugal couple, living in a small farm in which they resided and kept a small store. No records were kept of the amount of income earned and of the business transactions entered into from time to time, and it was impossible to determine accurately not only the amount of income received by Claude Ridley, but also to determine accurately the years in which such income was received. The purchases and expenditures made by the spouses appeared through the years 1937 to 1951, without any specific amount for any particular year. The District Court held that inasmuch as the oral testimony as well as the oral circumstances indicate that the investment purchases were made from accumulated savings rather than from current income and there being no evidence to indicate greater income in one year than in another, the income should be distributed evenly through the years 1937 and 1951, inclusive.

The above decision, does not sustain the argument adduced by counsel for petitioner. The facts found in the case at bar do not justify the petitioner's claim. Petitioner does not claim that the amounts appearing in the last period of the assessment were acquired through savings or accumulated savings or any slow and continuous process, such that the income cannot be distributed to any particular year of the period of assessment.

On the other hand, Section 39 of the National Internal Revenue Code requires the taxpayer to report yearly to the Collector of Internal Revenue the income that he gets during the year from whatever source and include the same

in the taxable year in which the income was received by him. It is to be presumed that the income was earned at the time that it appeared in the possession or control of the taxpayer, in accordance with the rule that the law has been followed. [Rule 123, Section 69 (q), Rules of Court] Were we to sanction the use of the spreading method claimed, We would be tolerating a violation of the law or rule that the taxpayer must report his income in the year it is earned. Under the practice advocated, a taxpayer would be encouraged to hide his income because in any case, if his unreported income would be discovered afterwards the said income, although appearing in one year, would be distributed over a period of years. In other words, we will have a rule, as advocated by petitioner's counsel that would not discourage the hiding of taxable income because any discovery of any unreported income could always be allowed to be distributed over a period of years. In the case at bar, the distribution over a period of years demanded by petitioner would bring about a reduction of the tax assessed by the Court of Tax Appeals from P424,536.77 to P232,416.59 (see computation attached to Motion For Reconsideration, Annex K of Petition For Review), or about one-half of the assessment made by the Court of Tax Appeals. We are not prepared to permit such un-authorized reduction in public taxes favorable to a dishonest taxpayer and prejudicial to the interests of the State.

Wherefore, finding no merit in the various supposed errors attributed to the Court of Tax Appeals in its decision, We hereby find that the decision is justified by law and the evidence. Wherefore, the decision appealed from is hereby affirmed, with costs against the petitioner. It is so ordered.

Bengzon, C.J., Padilla, Bautista Angelo, Concepcion, Reyes, J.B.L., Barrera, Paredes, Dizon, Regala and Makalintal, JJ., concur.

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