

(with Resolution of June 11, 1965)

G. R. No. L-19537. May 20, 1965

Ponente: BENGZON, J.P., J.

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BENGZON, J.P., J.:

Lino Gutierrez was primarily engaged in the business of leasing real property for which he paid real estate broker's privilege tax. He filed his income tax returns for the years 1951, 1952, 1953 and 1954 on the following dates:

1951

March 1, 1952

1962

February 28, 1958

1953

February 22, 1954

1954

February 23, 1955

and paid the corresponding tax declared therein.

On July 10, 1956 the Commissioner (formerly Collector) of Internal Revenue assessed against Gutierrez the following deficiency income tax:

1951

P1,400.00

1952

672.00

1953

5,161.00

1954

4,608.00

Total

P11,841.00

The above deficiency tax came about by the disallowance of deductions from gross income representing depreciation, expenses Gutierrez allegedly incurred in carrying on his business, and the addition to gross income of receipts which he did not report in his income tax returns. The disallowed business expenses which were considered by the Commissioner either as personal or capital expenditures consisted of:

1951

Personal expenses:

Transportation expenses to attend funeral of various persons

.P96.50

Repair of car and salary of driver

59.80

Expenses in attending: National Convention of Filipino Businessmen in Baguio

121.35

Alms to indigent family

15.00

Capital expenditures:

Electrical fixtures and supplies

P100.00

Transportation and other expenses to watch laborers in construction work

516.00

Realty tax not paid by former owner of property acquired by Gutierrez

350.00

Litigation expenses to collect rental and eject lessee

702.65

Other disallowed deductions:

Fines and penalties for late payment of taxes

P64.48

1952

Personal expenses:

Car expenses, salary of driver and car depredation

P1,454.37

Contribution to Lydia Yamson and G. Trinidad

52.00

Officers' jewels and apron donated to Biak-na-Bato Lodge No. 7, Free Masons

280.00

Luncheon of Homeowners' Association

5.50

Ticket to opera "Aida"

15.00

1953

Personal expenses:

Car expenses, salary of driver, car depreciation

P1,409.24

Cruise to Corregidor with Homeowners' Association

43.00

Contribution to alms to various individuals

70.00

Tickets to operas

28.00

Capital expenditures:

Cost of one set of Comments on the Rules of Court by Moran

P145.00

1954

Personal expenses:

Car expenses, salary of driver and car depreciation

P1,413.67

Furniture given as commission in connection with business transaction

115.00

Cost of iron door of Gutierrez' residence

55.00

Capital expenditures:

Painting of rental apartments

P908.00

Carpentry and lumber for rental apartments

335.83

Tinsmith and plumbing for rental apartments

605.25

Cement, tiles, gravel, sand and masonry for rental apartments

199.48

Iron bars, Venetian blind, water pumps for rental apartments

P1,340.00

Relocation and registration of property used in tax-payer's business.

1,758.12

He also claimed the depreciation of his residence as follows:

1952

P992.22

1953

942.61

1954

895.48

The following are the items of income which Gutierrez did not declare in his income tax returns:

1951

Income of wife (admitted by Gutierrez)

P2,749.90

1953

Overstatement of purchase price of real estate

P8,476.92

Understatement of profits from sale for real estate

5,803.74

1954

Understatement of profits from sale of real estate

P5,444.24

The overstatement of purchase price of real estate to the sale of two pieces of property in 1953. In Gutierrez bought a parcel of land situated along Padre Faura St. in Manila for P35,000.00. Sometime in 1953, he sold the same for P30,400.00. Expenses of sale amounted to P631.80. In his return he claimed a loss of P5,231.80[1] However, the Commissioner, concluding that said property was bought in Japanese military notes, converted the buying price to its equivalent in Philippine Commonwealth peso by the use of the Ballantyne Scale of Values. At P1.30 Japanese military notes per Commonwealth peso, the acquisition cost of P35,000.00 Japanese military notes was valued at P26,823.08 Philippine Commonwealth peso. Accordingly, the Commissioner determined a profit of P3,476.92 after restoring to Gutierrez' gross income the P5,231.80 deduction for loss.

In another transaction, Gutierrez sold a piece of land for P1,200.00. Alleging that said property was purchased for P1,200.00, he reported no profit thereunder. However, after verifying the deed of acquisition, the Commissioner discovered the purchase price to be only P800.00. Consequently, he determined a profit of P400.00 which was added to the gross income for 1953.

The understatement of profit from the sale of real estate may be explained thus: In 1953 and 1954 Gutierrez sold four other properties upon which he made substantial profits.[[2]] Convinced that said properties were capital assets, he declared only 50% of the profits from their sale. However, treating said properties as ordinary assets (as property held and used by Gutierrez in his business), the Commissioner taxed 100% of the profits from their disposition pursuant to Section 35 of the Tax Code.

Having unsuccessfully questioned the legality and correctness of the aforesaid assessment, Gutierrez instituted on February 17, 1958 an appeal to the Court of Tax Appeals. Later, on February 21, 1958, the Commissioner issued a warrant of distraint and levy on one of Gutierrez' real properties but desisted from enforcing the same when Gutierrez filed a bond to assure payment of his tax liability.

In a decision dated January 28, 1962, the Court of Tax Appeals upheld in toto the assessment of the Commissioner of Internal Revenue. Hence, this appeal.

On October 18, 1962 Lino Gutierrez died and he was substituted by Andrea C. Vda. de Gutierrez, Antonio D. Gutierrez, Santiago D. Gutierrez, Guillermo D. Gutierrez and Thomas D. Gutierrez, his heirs, as party petitioners.

The issues are: (1) Are the taxpayer's aforementioned claims for deduction proper and allowable? (2) May the Ballantyne Scale of Values be applied in determining the acquisition cost in 1943 of a real property sold in 1953 for income tax purposes? (3) Are real properties used in the trade or business of the taxpayer capital or ordinary assets? (4) Has the right of the Commissioner of Internal Revenue to collect the deficiency income tax for the years 1951 and 1952 prescribed? (5) Has the right of the Commissioner of Internal Revenue to collect by distraint and levy the deficiency income tax for 1964 prescribed? If not, may the taxpayer's real property be distrained and levied upon, without first exhausting his personal property?

We come first to the question whether or not the deductions claimed by Gutierrez are allowable. Section 30 (a) of

the Tax Code allows business expenses to be deducted from gross income. We quote:

Sec. 30. Deductions from, gross income.—In computing net income there shall be allowed as deductions—

"(a) Expenses:

"(1) In general.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for the purposes of the trade or business, or property to which the taxpayer has not taken or is not taking title of in which he has no equity."

To be deductible, therefore, an expense must be (1) ordinary and necessary; (2) paid or incurred within the taxable year; and, (3) paid or incurred in carrying on a trade or business. [[3]]

The transportation expenses which petitioner incurred to attend the funeral of his friends and the cost of admission tickets to operas were expenses relative to his personal and social activities rather than to his business of leasing real estate. Likewise, the procurement and installation of an Iron door to his residence is purely a personal expense. Personal, living, or family expenses are not deductible. [[4]]

On the other hand, the cost of furniture given by the taxpayer as commission in furtherance of a business transaction, the expenses incurred in attending the National Convention of Filipino Businessmen, luncheon meeting and cruise to Corregidor of the Homeowners' Association, were shown to have been made in the pursuit of his business. Commissions given in consideration for bringing about a profitable transaction are part of the cost of the business transaction and are deductible.

The record shows that Gutierrez was an officer of the Junior Chamber of Commerce which sponsored the National Convention of Filipino Businessmen. He was also the president of the Homeowners' Association, an organization established by those engaged in the real estate trade. Having proved that his membership thereof and activities in connection therewith were solely to enhance his business, the expenses incurred thereunder are deductible as ordinary and necessary business expenses.

With respect to the taxpayer's claim for deduction for car expenses, salary of his driver and car depreciation, one-third of the same was disallowed by the Commissioner on the ground that the taxpayer used his car and driver both for personal and business purposes. There is no clear showing, however, that the car was devoted more for the taxpayer's business than for his personal needs. [[5]] According to the evidence, the taxpayer's car was utilized both for personal and business needs. We therefore find it reasonable to allow as deduction one-half of the driver's salary, car expenses and depreciation.

The electrical supplies, paint, lumber, plumbing, cement, tiles, gravel, masonry and labor used to repair the taxpayer's rental apartments, did not increase the value of such apartments, or prolong their life. They merely kept the apartments in an ordinary operating condition. Hence, the expenses incurred therefor are deductible as necessary expenditures for the maintenance of the taxpayer's business.

Similarly, the litigation expenses defrayed by Gutierrez to collect apartment rentals and to eject delinquent tenants are ordinary and necessary expenses in pursuing his business. It is routine and necessary for one in the leasing business to collect rentals and to eject tenants who refuse to pay their accounts.

The following are not deductible business expenses but should be integrated into the cost of the capital assets for which they were incurred and depreciated yearly: (1) Expenses in watching over laborers in construction work. Watching over laborers is an activity more akin to the construction work than to running the taxpayer's business.

Hence, the expenses incurred therefor should form part of the construction cost. (2) Real estate tax which remained unpaid by the former owner of Gutierrez' rental property but which the latter paid, is an additional cost to acquire such property and ought therefore to be treated as part of the property's purchase price. (3) The iron bars, Venetian blind and water pump augmented the value of the apartments where they were installed. Their cost is not a maintenance charge, [6] hence, not deductible.[[7]] (4) Expenses for the relocation, survey and registration of property tend to strengthen title over the property, hence, they should be considered as addition to the cost of such property. (5) The set of "Comments on the Rules of Court" having a life span of more than one year should be depreciated ratably during its whole life span instead of its total cost being deducted in one year.

Coming to the claim for depreciation of Gutierrez' residence, we find the same not deductible. A taxpayer may deduct from gross income a reasonable allowance for deterioration of property arising out of its use or employment in business or trade.[[8]] Gutierrez' residence was not used in his trade or business.

Gutierrez also claimed for deduction the fines and penalties which he paid for late payment of taxes. While Section 30 allows taxes to be deducted from gross income, it does not specifically allow fines and penalties to be so deducted. Deductions from gross income are matters of legislative grace; what is not expressly granted by Congress is withheld. Moreover, when acts are condemned by law and their commission is made punishable by fines or forfeitures, to allow them to be deducted from the wrongdoer's gross income, reduces, and so in part defeats, the prescribed punishment. [9]

As regards the alms to an indigent family and various individuals, contributions to Lydia Yamson and G. Trinidad and a donation consisting of officers' jewels and aprons to Biak-na-Bato Lodge No. 7, the same are not deductible from gross income inasmuch as their recipients have not been shown to be among those specified by law. Contributions are deductible when given to the Government of the Philippines, or any of its political subdivisions for exclusively public purposes, to domestic corporations or associations organized and operated exclusively for religious, charitable, scientific, athletic, cultural or educational purposes, or for the rehabilitation of veterans, or to societies for the prevention of cruelty to children or animals, no part of the net income of which inures to the benefit of any private stockholder or individual.[10]

We come to the question whether or not the Ballantyne Scale of Values can be applied to tax cases.

Sometime in 1943 Gutierrez bought a piece of real estate in Manila for a price of P35,000.00. In 1953 he sold said property for P30,400.00, thereby incurring a loss which he claimed as deduction in his income tax return for 1953. The Commissioner of Internal Revenue, convinced that the purchase price of the property in 1943 was in Japanese military notes, converted said purchase price into Philippine Commonwealth pesos by the use of the Ballantyne Scale of Values. As a result, the Commissioner found Gutierrez to have profited, instead of lost in the sale.

Firstly, Gutierrez maintains that the purchase price was paid for in Commonwealth pesos. On the other hand the Commissioner insists that inasmuch as the prevailing currency in the City of Manila in 1943 was the Japanese military issue, the transaction could have been in said military notes. The evidence offered by Gutierrez, consisting of the testimony of his son to the effect that it was he who carried the bundle of Commonwealth pesos and Japanese military notes when his father purchased the property, did not convince the Tax Court. No cogent reason to alter the court a quo's finding of fact in this regard has been given. There is no definite showing that Gutierrez paid for the property in Commonwealth pesos. Considering that in 1943 the medium of exchange in Manila was the Japanese military notes, the use of which the Japanese Military Government enforced with stringent measures, we are inclined to concur with the finding that the purchase price was in Japanese military notes. We are specifically mindful of the fact that Gutierrez sold the property in 1953 for only P30,400.00 at a time when the price of real estate in the City of Manila was much greater than in 1943.

It is further contended by Gutierrez that the money he used to pay for the purchase of the property in question came from the proceeds of merchandise acquired prior to World War II but which he sold after Manila was occupied by the Japanese military forces, hence the purchase price should be deemed to have been made in Commonwealth pesos inasmuch as the aforesaid merchandise was purchased in Commonwealth pesos. This contention, if true, strengthens our conclusion that the real estate in question was bought in Japanese military notes. For, at the time Gutierrez sold his merchandise, the prevailing currency in the City of Manila was the Japanese military money. Consequently, the proceeds therefrom, which was used to buy the real estate in question, were Japanese military notes.

Gutierrez assails the use of the Ballantyne Scale of Values in converting the purchase price of the real estate in question from Japanese military notes to Philippine Commonwealth pesos on the ground that (1) the Ballantyne Scale of Values was intended only for transactions entered into by parties voluntarily during the Japanese occupation, wherein a portion of the contract was left unperformed until liberation of the Philippines by the American[^]; (2) that such Scale of Values cannot be the basis of a tax, for it is not a law.

In determining the gain or loss from the sale of property the purchase price and the selling price ought to be in the same currency. Since in this case the purchase price was in Japanese military notes and the selling price was in our present legal tender, the Japanese military notes should be converted to the present currency. Since the only standard scale recognized by courts for the purpose is the Ballantyne Scale of Values, we find it compelling to use such table of values rather than adopt an arbitrary scale. It may not be amiss to state in this connection that the Ballantyne Scale of Values is not being used herein as the authority to impose the tax, but only as a medium of computing the tax base upon which the tax is to be imposed.

It is furthermore proffered by the taxpayer that in determining gain or loss, the real value of the Commonwealth peso at the time the property was purchased and the value of the Republic peso at the time the same property was sold should be considered. The Commonwealth peso and the Republic peso are the same currency, with the same intrinsic value, sanctioned by the same authorities. Both are legal tender and accepted at face value regardless of fluctuation in their buying power. The 1941 Commonwealth peso when used to buy in 1953 or in 1965 is accorded the same value: one peso.

In his income tax returns for 1953 and 1954, Gutierrez reported only 50% of profits he realized from the sale of real properties during the years 1953 and 1954 on the ground that said properties were capital assets. Profits from the sale of capital assets are taxable to the extent of 50% thereof pursuant to Section 34 of the Tax Code.

Section 34 provides:

"Sec. 34. Capital gains and losses.—(a) Definitions.—As used in this title—

"(1) Capital assets.—The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in subsection (f) of section thirty; or real property used in the trade or business of the taxpayer.

* * * * *

(b) Percentage taken into account.—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized' upon the sale or exchange of capital asset shall be taken Into account in computing net capital gain, net capital loss, and net income:

"(1) One hundred per centum if the capital asset has been held for not more than twelve months;

"(2) Fifty per centum if the capital asset has been held for more than twelve months."

Section 34, before it was amended by Republic Act 82 in 1947, considered as capital assets real property used in the trade or business of a taxpayer. However, with the passage of Republic Act 82, Congress classified 'real property used in the trade or business of the taxpayer' as ordinary asset. The explanatory note to Republic Act 82 says: ". . . the words 'or real property used in the trade or business of the taxpayer' have been included among the non-capital assets. This has the effect of withdrawing the gain or loss from the sale or exchange of real property used in the trade or business of the taxpayer from the operation of the capital gains and losses provisions. As such real property is used in the trade or business of the taxpayer, it is logical that the gain or loss from the sale or exchange thereof should be treated as ordinary income or loss." [11] Accordingly, the real estate, admittedly used by Gutierrez in his business, which he sold in 1953 and 1964 should be treated as ordinary assets and the gain from the sale thereof, as ordinary gain, hence, fully taxable.[12]

With regard to the issue of the prescription of the Commissioner's right to collect deficiency tax for 1951 and 1952, Gutierrez claims that the counting of the 5- year period to collect income tax should start from the time the income tax returns were filed. He, therefore, urges, us to declare the Commissioner's right to collect the deficiency tax for 1951 and 1952 to have prescribed, the income tax returns for 1951 and 1952 having been filed in March 1952 and on February 28, 1953, respectively, and the action to collect the tax having been instituted on March 5, 1958 when the Commissioner filed his answer to the petitioner for review in C.T.A. Case No. 504. On the other hand, the Commissioner argues that the running of the prescriptive period to collect commences from the time of assessment. Inasmuch as the tax for 1951 and 1952 were assessed only on July 10, 1956, less than five years lapsed when he filed his answer on March 5, 1958.

The period of limitation to collect income tax is counted from the assessment of the tax as provided for in paragraph (c) of Section 332 quoted below:

"Sec. 332(e) Where the assessment of any internal-revenue tax has been made with the period of limitation above prescribed such tax may be collected by distraint or levy or by a proceeding in court, but only if begin (1) within five years after the assessment of the tax, or (2) prior to the expiration of any period for collection agreed upon in writing by the Collector of Internal Revenue and the taxpayer before the expiration of such five-year period. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon."

Inasmuch as the assessment for deficiency income tax was made on July 10, 1956 which is 7 months and 25 days prior to the action for collection, the right of the Commissioner to collect such tax has not prescribed.

The next issue relates to the prescription of the right of the Commissioner of Internal Revenue to collect the deficiency tax for 1954 by distraint and levy.

The pertinent provision of the Tax Code states:

Sec. 51 (c) Refusal or neglect to make returns; fraudulent returns, etc.—In cases of refusal or neglect to make a return and in cases of erroneous, false, or fraudulent returns, the Collector of Internal Revenue shall, upon the discovery thereof at any time within three years after said return is due, or has been made, make a return upon information obtained as provided for in this code or by existing law, or require the necessary corrections to be made, and the assessment made by the Collector of Internal Revenue thereon shall be paid by such person or corporation immediately upon notification of the amount of such assessment.

On February 23, 1955 Gutierrez filed his income tax return for 1954 and on February 24, 1958 the Commissioner

of Internal Revenue issued a warrant of distraint and levy to collect the tax due thereunder. Gutierrez contends that the Commissioner's right to issue said warrant is barred, for the same was issued more than 3 years from the time he filed his income tax return. On the other hand, the Commissioner of Internal Revenue maintains that his right did not lapse inasmuch as from the last day prescribed by law for the filing of the 1954 return to the date when he issued the warrant of distraint and levy less than 3 years passed. The question now is: should the counting of the prescriptive period commence from the actual filing of the return or from the last day prescribed by law for the filing thereof?

We observe that Section 51 (d) speaks of erroneous, false or fraudulent returns and refusal or neglect of the taxpayer to file a return. It also provides for two dates from which to count the three-year prescriptive period, namely, the date when the return is due and the date the return has been made. We are inclined to conclude that the date when the return is due refers to cases where the taxpayer refused or neglected to file a return, and the date when the return has been made refers to instances where the taxpayer filed erroneous, false or fraudulent returns. Since Gutierrez filed an income tax return, the three-year prescriptive period should be counted from the time he filed such return. From February 23, 1955 when the income tax return for 1954 was filed, to February 24, 1958, when the warrant of distraint and levy was issued, 3 years and 2 days elapsed. The right of the Commissioner to issue said warrant of distraint and levy having lapsed by two days, the warrant issued is null and void.

The above finding has made academic the question of whether or not the warrant of distraint and levy can be enforced against the taxpayer's real property without first exhausting his personal properties.

In resume, the tax liability of Lino Gutierrez 1951, 1952, 1953 and 1954 may be computed as follows:

1951

Net income per investigation

P29,471.81

Add: Disallowed deductions for salary of driver and car expenses

29.90

P29,501.71

Less: Allowable deductions:

Expenses in attending National Convention of Filipino businessmen

P121.35

Repair of rental apartments

802.65

924.00

Net income

P30,425.71

Less: Personal exemption

3,600.00

Amount subject to tax

P26,825.71

Tax due thereon

P 5,668.00

Less tax already paid

3,981.00

Deficiency income tax due

P 1,687.00

1952

Net income per investigation

P21,632.22

Add: Disallowed deductions:

Salary of driver

P260.67

Car expenses

401.51

Car depreciation

65.00

727.18

P22,359.40

Less: Allowable deduction:

Luncheon, Homeowners' Association

5.50

Net income

P22,364.90

Less: Personal exemption

3,600.00

Amount subject to tax.

P18,764.90

Tax due thereon

P 3,324.00

Less tax already paid

2,476.00

Deficiency income tax due

P 848.00

1953

Net income per investigation

P69,180.91

Add: Disallowed deductions:

Salary of driver

P140.00

Car expenses

406.00

Car depreciation

58.50

604.50

P69,785.10

Less: Allowable deduction:

Cruise to Corregidor with Homeowners Association

42.00

Net income

P69,828.40

Less: Personal exemption

3,600.00

Amount subject to tax

P66,228.40

Tax due thereon

P15,179.00

Less tax already paid

9,805.00

Deficiency income tax due

P 5,374.00

1954

Net income per investigation

P43,881.92

Add: Disallowed deductions:

Salary of driver

P140.00

Car expenses

414.18

Car depreciation

72.65

626.83

P44,508.75

Less: Allowable deductions:

Furniture given in connection with business transaction

P115.00

Repairs of rental apartments

2,048.56

P 2,163.56

Net income

P42,345.19

Less: Personal exemption

3,000.00

Amount subject to tax

P39,345.19

Tax due thereon

P 9,984.00

Less tax already paid

5,964.00

Deficiency income tax due

P 4,020.00

SUMMARY

1951

P 1,687.00

1952

848.00

1953

5,374.00

1954

4,020.00

Total.

P11,929.00

Wherefore, the decision appealed from is modified and Lino Gutierrez and/or his heirs, namely, Andrea C, Vda. de Gutierrez, Antonio D. Gutierrez, Santiago D. Gutierrez, Guillermo D. Gutierrez and Tomas D. Gutierrez, are ordered to pay the sums of P1,687.00, P848.00, P5,374.00, and P4,020.00, as deficiency income tax for the years 1951,1952,1953 1954, respectively, or a total of P11,929.00, plus the statutory penalties in case of delinquency. No costs. So ordered.

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

[1] P35,000 plus P651.80, minus P30,400.00.

[2] P11,607.50 in 1953 and P10,888.47 in 1954.

[3] Collector of Internal Revenue vs. Philippine Education Co., 99 Phil.,319; 54 Off. Gaz., 2499.

[4] Section 31 (a) (1), National Internal Revenue Code.

[5] Collector of Internal Revenue vs. Jamir, L-16552, March 20, 1962.

[6] Alhambra Cigar & Cigarette Mfg. Co. vs. Collector of Internal Revenue, L-12026, May 29, 1959.

[7] Section 30 (a) (2), National Internal Revenue Code.

[8] Section 30 (f) (1), National Internal Revenue Code.

[9] Jerry Rossman Corporation vs. Commissioner of Internal Revenue, 175 F 2d 711, 713.

[10] Section 30 (h), National Internal Revenue Code.

[11] See Montejo, Cirilo G., National Internal Revenue Code Annotated, pp. 125-126.

[12] Section 30 (b), National Internal Revenue Code; Collector of Internal Revenue vs. Bautista, L-12250, May 27, 1950.

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