

**REPUBLIC OF THE PHILIPPINES, PLAINTIFF-APPELLANT, VS.
LEONOR DE LA RAMA, ET AL., RESPONDENTS-APPELLEES.***G. R. No. 21108. November 29, 1966*

Ponente: ZALDIVAR. J.

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This is an appeal from the decision of the Court of First Instance of Manila, dated December 23, 1961, in its Civil Case No. 46494, dismissing the complaint of the Republic of the Philippines against the heirs of the late Esteban de la Rama for the collection of 956,032.50 as deficiency income tax, inclusive of 50% surcharge, for the year 1950.

The estate of the late Esteban de la Rama was the subject of Special Proceedings No. 401 of the Court of First Instance of Iloilo. The executor-administrator, Eliseo Hervas, filed on March 12, 1951, income tax returns of the estate corresponding to the taxable year 1950, declaring a net income of 922,796.59, on the basis of which the amount of P3,919.00 was assessed and was paid by the estate as income tax. The Bureau of Internal Revenue later claimed that it had found out that there had been received by the estate in 1950 from the De la Rama Steamship Company, Inc. cash dividends amounting to 966,800.00, which amount was not declared in the income tax return of the estate for the year 1950. The Bureau of Internal Revenue then, on March 7, 1956, made an assessment as deficiency income tax against the estate in the sum of 956,032.50, of which amount 937,355.00 was the deficiency and 918,677.50 was the 50% surcharge.

The Collector of Internal Revenue wrote a letter, dated February 29, 1956, to Mrs. Lourdes de la Rama-Osmeña informing her of the deficiency income tax and asking payment thereof. On March 13, 1956 the letter's counsel wrote to the Collector acknowledging receipt of the assessment, but contended that Lourdes de la Rama-Osmeña had no authority to represent the estate, and that the assessment should be sent to Leonor de la Rama who was pointed to by said counsel as the administratrix of the estate of her late father. On the basis of this information the Deputy Collector of Internal Revenue, on November 22, 1956, sent a letter to Leonor de la Rama as administratrix of the estate, asking payment. The tax, as assessed, not having been paid, the Deputy Commissioner of Internal Revenue, on September 7, 1959, wrote another letter to Mrs. Lourdes de la Rama-Osmeña demanding, through her, upon the heirs, the payment of the deficiency income tax within the period of thirty days from receipt thereof. The counsel of Lourdes de la Rama-Osmeña, in a letter dated September 25, 1959, insisted that the letter should be sent to Leonor de la Rama. The Deputy Commissioner of Internal Revenue wrote to Leonor de la Rama another letter, dated February 11, 1960, demanding, through her as administratrix, upon the heirs of Esteban de la Rama, the payment of the sum of P56,032.50, as deficiency income tax including the 50% surcharge, to the City Treasurer of Pasay City within thirty days from receipt thereof.

The deficiency income tax not having been paid, the Republic of the Philippines filed on March 6, 1961 with the Court of First Instance of Manila a complaint against the heirs of Esteban de la Rama, Making to collect from each heir his/her proportionate share in the income tax liability of the estate. An amended complaint dated August 31, 1961, was admitted by the court.

The defendants-appellees, Lourdes de la Rama-Osmeña, Leonor de la Rama, Estefanla de la Rama-Pirovano, Dolores de la Rama-Lopez, Charles Miller, and Aniceta de la Rama-Sian, thru counsel, filed their respective answers, the gist of their allegations and/or defenses being (1) that no cash dividends of 966,800.00 had been paid to the estate; (2) that the administration of the estate had been extended by the probate court precisely for the purpose of collecting said dividends; (3) that Leonor de la Rama had never been administratrix of the estate; (4) that the executor of the estate, Eliseo Hervas, had never been given notice of the assessment, and consequently the assessment had never become final; and (5) that the collection of the alleged deficiency income tax had prescribed. Fausto F. Gonzales, Jr., one of the defendants, not having filed an answer, was declared in default.

From the evidence introduced at the trial, both oral and documentary, the lower court found that the dividend of 966,800.00 declared by the De la Rama Steamship Co. in favor of the late Esteban de la Rama was applied to the obligation of the estate to the company declaring the dividends; that Leonor de la Rama was not the administratrix of the estate, but it was the late Eliseo Hervas who was the executor-administrator; that the administration of the estate was extended for the purpose of recovering for the estate said dividends from the De la Rama Steamship Co., Inc; and that the question of whether the deceased Esteban de la Rama was a debtor to the entity known as the Hijos de I. de la Rama, which was also indebted to the De la Rama Steamship Co., Inc., was not a settled one.

After trial, the lower court rendered its decision, dated December 23, 1961, dismissing the complaint. The Republic of the Philippines appealed from said decision to the Court of Appeals, but the appeal was later certified to this Court because only questions of law are involved.

Plaintiff-appellant contends that the trial court erred (1) in holding that there was no basis for the assessment upon the ground that it was not proved that the income in question was received by the estate of Esteban de la Rama or by his heirs; (2) in not holding that the income was constructively received by the estate of the late Esteban de la Rama; (3) in not holding that the heirs and legatees of the late Esteban de la Rama were liable for the payment of the deficiency income tax; (4) in not holding that the assessment involved in the case had long become final; (5) in not holding that the service of the notice of assessment on Lourdes de la Rama-Osmeña and Leonor de la Rama was proper and valid; and (6) in not holding that said court had no jurisdiction to take cognizance of appellees' defense that the assessment in question was erroneous.

Plaintiff-appellant argues that the deficiency income tax in this case was assessed in the sum of 986,800. 00 representing cash dividends declared in 1950 by the De la Rama Steamship Co., Inc. in favor of the late Esteban de la Rama and was applied as payment of the latter's account with the former. The application of payment appears in the books of said creditor company as follows:

"Against accounts receivable due from Esteban de la Rama.

P25,255.24

"Against the account due from Hijos de I. de la Rama, Inc., of which Don Esteban de la Rama was the principal owner

P61,544.76

Total

P86,800.00"

The plaintiff-appellant maintains that this crediting of accounts in the books of the company constituted a constructive receipt by the estate or the heirs of Esteban de la Rama of the dividends, and this dividend was an income of the estate and was therefore, taxable.

It is not disputed that the dividends in question were not actually paid either to the estate, or to the heirs, of the late Esteban de la Rama. The question to be resolved is whether or not the said application of the dividends to the personal accounts of the deceased Esteban de la Rama constituted constructive payment to, and hence, constructively received by, the estate or the heirs. If the debts to which the dividends were applied really existed, and were legally demandable and chargeable against the deceased, there was constructive receipt of the dividends; if there were no such debts, then there was no constructive receipt.

The first debt, as above Indicated, had been contested by the executor-administrator of the estate. It does not even appear that the De la Rama Steamship Co., Inc. had ever filed a claim against the estate in connection with that indebtedness. The existence and the validity of the debt is, therefore, in dispute, and there was no proof adduced to show the existence and validity of the debt.

The second debt to which the dividends were partly applied were accounts "due from Hijos de I. de la Rama, Inc." The alleged debtor here was an entity separate and distinct from the deceased. If that was so, its debts could not be charged against the deceased, even if the deceased was the principal owner thereof, in the absence of proof of substitution of debtor. There is no evidence in the instant case that the late Esteban de la Rama substituted the "Hijos de I. de la Rama" as debtor to the De la Rama Steamship Co., Inc.; nor was there evidence that the estate of the late Esteban de la Rama owned the "Hijos de I. de la Rama, Inc.," this fact being, as found by the lower court, not a settled question because the same was denied by the administrator.

Under the National Internal Revenue Code, income tax is assessed on income that has been received. Thus, Section 21 of the Code requires that the income must be received by an individual before a tax can be levied thereon.

"Sec. 21. Rates of tax on citizens or residents.—There shall be levied, collected, and paid annually upon the entire income received in the preceding taxable year from all sources by every individual, or citizen or resident of the Philippines, x x x."

Section 56 also requires receipt of income by an estate before an Income tax can be assessed thereon. It provides:

"Sec. 56. Imposition of tax—(a) Application of tax. - The taxes imposed by this Title upon individuals shall apply to the income of estates or of any kind of property held in trust including—

(3) Income received by estate of deceased persons during the period of administration or settlement of the estate; x x x."

Hence, if income has not been received, no income tax can be assessed thereon. Inasmuch as the income was not received either by the estate, or by the heirs, neither the estate nor the heirs can be liable for the payment of income tax therefor.

The trial court, therefore, did not err when it held in its decision that:

"After a study of the proofs, the Court is constrained to sustain the position of the defendants on the fundamental issue that there could have been no correct and real basis for the assessment or that there is no proof that the income in question had been received; it was not actually delivered unto the Estate since it was retained by the De la Rama Steamship Co., Inc.; which applied said dividends to certain accounts receivable due from the deceased allegedly, Exh. A-I; now if truly there had been such indebtedness owing from the deceased unto said De la Rama Steamship Co., Inc., the Court will agree with plaintiff that the offsetting of the dividends against such indebtedness amounted to constructive delivery; but here has not been presented any proof to that effect, i.e., that there was such an indebtedness due from deceased; on the contrary what the evidence shows is that the former administrator of the Estate had challenged the validity of said indebtedness, Exh. D, motion of 4 June, 1951; this being the case, there is no clear showing that income in the form of said

dividends had really been received, which is the verb used in Section 21 of the Internal Revenue Code, by the Estate whether actually or constructively; and the income tax being collected by the Government on income received, the Government's position is here without a clear basis; the position becomes worse when it be considered that it is not even the Estate that is being sued but the heirs themselves, who admittedly had not received any of said dividends themselves; the fiction of transfer of ownership by succession from the death of the decedant will have to give way to. actual fact that the dividends have not been adjudicated at all to the heirs up to now at least so far as the evidence shows. This being the conclusion of the Court, there will be no need to discuss the question of whether the action has or has not prescribed."

The factual findings of the trial court, as stated in the above-quoted portion of the decision, is decisive in the determination of the legal issues in this case.

Appellant cites the case of *Herbert v. Commissioner of Internal Revenue* 81 F (2d) 912 as authority that the crediting of dividends against accounts constitutes payment and constructive receipt of the dividends. The citation of authority misses the point in issue. In that case the existence of the indebtedness of Leon S. Herbert to the corporation that declared the dividends and against which indebtedness the dividends were applied, was never put in issue, and was admitted. In the instant case, the existence of the obligations has been disputed and, as the trial court found, has not been proved. It having been shown in the instant case that there was no basis for the assessment of the income tax, the assessment itself and the sending of notices regarding the assessment would neither have basis, and so the assessment and the notices produced no legal effect that would warrant the collection of the tax.

The appellant also contends that the assessment had become final, because the decision of the Collector of Internal Revenue was sent in a letter dated February 11, 1960 and addressed to the heirs of the late Esteban de la Rama, through Leonor de la Rama as administratrix of the estate, and was not disputed or contested by way of appeal within thirty days from receipt thereof to the Court of Tax Appeals. This contention is untenable. The lower court found that Leonor de la Rama was not the administratrix of the estate of Esteban de la Rama. The alleged deficiency income tax for 1950 was chargeable against the estate of the deceased Esteban de la Rama. On December 5, 1955, when the letter of notice for the assessment of the deficiency income tax was first sent to Leonor de la Rama (See Annex "A" of Answer of defendant Lourdes de la Rama-Osmeña, pp. 16-17, Record on Appeal), the administration proceedings, in Special Proceedings No. 401 of the Court of First Instance of Iloilo, were still open with respect to the controverted matter regarding the cash dividends upon which the deficiency assessment was levied. This is clear from the order dated June 21, 1951 (Exhibit "E") of the Court of First Instance of Iloilo which in part provides:

"El albacea-administrador hace constar, sin embargo, que quedan por cobrar ciertos dividendos declarados y devengados por las acciones del finado Esteban de la Rama en The De la Rama Steamship Co., Inc., que los funcionarios de dicha corporation x x x no nan pagado aun x x x y que por tales motivos habria necesidad de prolongar la administracion, solamente para que esta continúe atendiendo, con autorizacion, a tales menesteres.

"Se ordena el cierre de la Administración; pero se provee, sin embargo, la extensión de la misma, solamente para el proposito de iniciar y proseguir hasta eu terminacion una accion contra The De la Rama Steamship Co., Inc. para el cobro de dividendos declarados por dicha corporación en Diciembre 31, 1950 sobre las 869 acciones del finado Esteban de la Rama en la misma x x x.

"Y finalmente, queda relevado al Administrador Sr. Eliseo Hervas de toda responsibilidad en relaci&ón con su administración, excepto en lo que respecta al cobro de dividendos x x x."

The estate was still under the administration of Eliseo Hervas as regards the collection of said dividends. The administrator was the representative of the estate, whose duty it was to pay and discharge all debts and charges on

the estate and to perform all orders of the court by him to be performed (Rule 81, Section 1), and to pay the taxes and assessments due to the Government or any branch or subdivision thereof (Section 7, Rule 89, Old Rules of Court). The tax must be collected from the estate of the deceased, and it is the administrator who is under obligation to pay such claim (*Estate of Claude E. Haygood, Collector of Internal Revenue v. Haygood*, 65 Phil., 520). The notice of assessment, therefore, should have been sent to the administrator. In this case, notice was first sent to Lourdes de la Rama-Osmeña on February 29, 1956, and later to Leonor de la Rama on November 27, 1956, neither of whom had authority to represent the estate. As the lower court said in its decision: "Leonor de la Rama was not the administratrix of the estate of the late Esteban de la Rama and as such the demand unto her, Exh. Def. 8, p. 112, was not a correct demand before November 27, 1956, because the real administrator was the late Eliseo Hervas; x x x." (p. 45, Record on Appeal) The notice was not sent to the taxpayer for the purpose of giving effect to the assessment, and said notice could not produce any effect. In the case of *Bautista and Corrales Tan v. Collector of Internal Revenue*, L-12259, May 27, 1959, this Court had occasion to state that "the assessment is deemed made when the notice to this effect is released, mailed or sent to the taxpayer for the purpose of giving effect to said assessment." It appearing that the person liable for the payment of the tax did not receive the assessment, the assessment could not become final and executory (R. A. 1125, Section 11).

Plaintiff-appellant also contends that the lower court could not take cognizance of the defense that the assessment was erroneous, this being a matter that is within the exclusive jurisdiction of the Court of Tax Appeals. This contention has no merit. According to Republic Act 1125, the Court of Tax Appeals has exclusive jurisdiction to review by appeal decisions of the Collector of Internal Revenue in cases involving disputed assessments, and the disputed assessment must be appealed by the person adversely affected by the decision within thirty days after the receipt of the decision. In the instant case, the person adversely affected should have been the administrator of the estate, and the notice of the assessment should have been sent to him. The administrator had not received the notice of assessment, and he could not appeal the assessment to the Court of Tax Appeals within 30 days from notice. Hence the assessment did not fall within the exclusive jurisdiction of the Court of Tax Appeals.

IN VIEW OF THE FOREGOING, the decision appealed from should be, as it is hereby, affirmed, without costs.

Concepcion, C.J., Reyes, J.B.L., Barrera, Dizon, Regala, Makalintal, Bengzon, J.P., Sanchez and Ruiz Castro, JJ., concur.

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