

THE GOVERNMENT OF THE PHILIPPINE ISLANDS, PLAINTIFF AND APPELLANT, VS. ASUNCION MICHEL ET AL., DEFENDANTS AND APPELLANTS.

G.R. No. 32767. September 30, 1930

Ponente: JOHNS, J.

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JOHNS, J.:

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In its appeal the Government contends that the defendants are legally liable for the payment of income tax for the year 1927 on the amount of the bad debts which were charged off in that year by the estate.

That involves the construction of the sixth paragraph of section 5 (a), of Act No. 2833, as amended by section 8, of Act No. 2926, which provides that for the purpose of the income tax, there shall be allowed as deductions:

"Sixth. Debts due to the taxpayer actually ascertained to be worthless and charged off within the year."

Upon that point the lower court said:

"Section 5 of Act No. 2833, as amended by section 3 of Act No. 2926, provides that, for the purposes of taxation, deductions shall be allowed, among other things, for 'debts due to the taxpayer actually ascertained to be worthless and charged off within the year (Paragraph 6.) According to this provision, the debts in question could not have been deducted from the income for the years prior to 1927, nor could defendant Asuncion Michel Vda. de Sy Quia by herself alone, as administratrix of the estate, make any deduction from the income of preceding years without first obtaining judicial authorization to do so, and as has already been said, such debts were only considered worthless and charged off from the account of the estate by an order of the court effective on October 1, 1927, on (which date the accounts, of said estate were closed. Therefore, their deduction as losses in the tax declaration for the year 1927 is just and legitimate."

December 1, 1927, the administratrix of the estate filed with the Collector of Internal Revenue her income tax return in which it was stated that the sum of P284,947.49 was charged off, for the reason that it was then found that debts of that amount were worthless. That return was based upon the report which the administratrix of the estate made to the court, and which was authorized and approved by the court, from which it appears, and the court found as a fact, that the amount was evidenced by old judgments in favor of the estate against defendants which were unknown to the administratrix, some of whom have died, and that no part of the debts could be collected. The Government does not claim or assert that the debts were not worthless or that they were of any value to the estate, but relying upon the strict and technical letter of the law, it contends that because the debts were not "changed off within the year," that in legal effect the defendants are liable for the payment of an income tax on the amount of the bad debts.

It must be conceded that, as to a private person, there (would be much force in that contention. But in the instant case, during the period in question the estate of Pedro Sy Quia was in the course of administration, and at all times the administratrix was subject to the orders of the court, and did not have any legal right to charge off the bad debts in question, without the consent and approval ,of the court, which was applied for and finally obtained on the 1st day of November, 1927. Based upon which the administratrix filed her income tax return with the Collector of Internal Revenue on December 1, 1927, in which she stated that the P284,947.49 was charged off, for the reason that it was then ascertained that debts of that amount due and owing the estate were worthless and of no value. That is to say, in the year, 1927, it was for the first time then ascertained and legally determined that the full amount of P284,947.49 was worthless, and after that fact was ascertained and on the first of December, 1927, that amount was charged off as worthless debts. As stated, there is no claim or pretense that any part of the whole amount can be collected or is an asset of the estate.

Applying those facts to the provisions of the law above quoted, it would be unjust and inequitable to require the defendants, in legal effect, to pay an income tax on the amount of the bad debts in question, in particular, where the claim of the Government is against an estate, and arose during the course of administration. Upon that point, the judgment of the lower court is affirmed.

The remaining question involves the construction of section 2 of Act No. 2833, as amended by Act No. 2926.

Section 2 of Act No. 2926 provides:

* * * * *

"(c) The gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, shall be determined in accordance with the following schedule:

""(1) In the case of property acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen.

""(2) In the case of property acquired on or before March first, nineteen hundred and thirteen, the fair market price or value of such property as of the date of the acquisition thereof."

And section 2 of the amended Act No. 2833 provides:

"(a) Subject only to such exemptions and deductions as are hereinafter allowed, the taxable net income of a person shall include 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, businesses, trade, commerce, sales or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains, profits and income derived from any source whatever.

* * * * *

"(c) For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain! derived."

And subdivision (c) of section 4, cited by the defendants, is as follows:

"(c) The value of property acquired by gift, bequest, devise, or descent, but the income; from such property shall be included as income."

In construing those sections, the lower court well said:

"It clearly appears that even when the value of inherited property is exempt from the payment of said tax the income from such property, whether rents or profits derived from a transfer thereof, are to be considered income, and as such subject to the income tax."

The defendants and their predecessors in interest held and were in possession of the property acquired by the railroad company prior to the year 1913, from which it follows that the actual market value of the property in 1913 must be taken as the basis for the income tax which the defendants should pay in 1927. Upon that question both parties offered evidence, and out of its conflict the trial court found as a fact that the actual market value of the property in questioning the year 1913 was P88,383.90, and there is ample evidence to support its findings. It then found as a fact, about which there is no dispute, that the price that the Manila Railroad Company paid for the property was P439,395.53, the interest upon which from the date it took possession until the date of the payment was P236,221.55, and that for the year 1927 the estate received rents amounting to P35,500, and interest on notes, mortgages, and bank deposits P16,612.40, making a total of P727,729.48, from which it deducted P88,383.90, the market value of the real estate in question for the year 1913.

In the final analysis, it found that there was due and owing from the defendants P21,945.96 as income tax, surcharges, and interest, as provided for in section 9 (a), of Act No. 2833 from March 19, 1928.

The defendants vigorously contend that the value of the property acquired by the railroad company is nearly four times the amount found by the lower court in the condemnation proceedings, which judgment was later affirmed by this court.[1] Suffice it to say, that judgment, as to the value of the property at the time it was condemned, is final and conclusive.

The real question, is whether or not the defendants should pay an income tax on the amount of the increase in the market value of the property between the years 1913 and 1927. That question was squarely met and decided by the Supreme Court of the United States in the case of *Merchants' Loan & Trust Company vs. Smietanka* (255 U. S., 509), in which that court held:

"3. A gain or profit derived from the sale by a testamentary trustee of personal property of the estate which has appreciated in value over its market value on March 1, 1913, the testator having died prior to that date, and the property being among the assets which came to the trustee, is taxable under the Act of September 8, 1916, sec. 2a, as amended by the Act of October 3, 1917, which defines the income of a taxable person as including gains, profits, and income derived from sale or dealings in property, whether real or personal, growing out of the ownership or use of, or interest in, real or personal property, or gains or profits and income derived from any source whatever."

The facts in that case are almost identical with the facts in this case, and the legal questions therein decided are conclusive and binding on this court.

It follows that the judgment of the lower court upon that point must also be sustained. Neither party to recover costs on this appeal. So ordered.

Avanceña, C. J., Malcolm, Villamor, Ostrand and Villa-Real, JJ., concur.

[1] *Manila Railroad Co. vs. Mitchel* (49 Phil., 801).

CONCURRING AND DISSENTING

Street, J.:

I concur in the conclusions reached in this case on all points except that which has relation to the allowance of P284,947.49 as bad debts, deductible from the income of the estate of Pedro Sy Quia y Encarnacion for the year 1927. All of these old debts, except one, were reduced to judgment years before the Income Tax Law was enacted in these Islands, and the judgments on all of them were so obviously worthless that no execution, it is said, was ever sued out upon them. Moreover, the administratrix of the estate did not think enough of the claims to include them in the accounts receivable which she filed in the intestate proceedings of the decedent. The idea that they had a value for any purpose apparently first came into existence in 1929, when a motion was filed by the administratrix to have them declared worthless from the then anterior date of November 1, 1927,—a step evidently taken with the design to lay a basis for deducting them from taxable income for the year 1927. In my opinion these claims do not represent losses pertaining to that year, and hence they are not properly deductible from the income of that year.

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