

PHILIPPINE SUGAR ESTATE DEVELOPMENT CO., INC., PLAINTIFF AND APPELLEE, VS. JUAN POSADAS, COLLECTOR OF INTERNAL REVENUE, DEFENDANT AND APPELLANT.

G.R. No. 45189, May 26, 1939

Ponente: VILLA-REAL, J.

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VILLA-REAL, J.:

Upon the submission of the present case to the Court of First Instance of Manila on an stipulation of facts, a decision was rendered, the dispositive part of which reads:

"In view of the foregoing, the court finds the action brought by plaintiff to be in accordance with law, and, therefore, orders the Collector of Internal Revenue to refund to plaintiff the sum claimed of P2,915.45, without costs."

From this decision defendant Juan Posadas, in his capacity as Collector of Internal Revenue, took an appeal, assigning six alleged errors committed by the court a quo in its judgment referred to, which we shall presently discuss.

The first question to be determined is that raised by the first assignment of alleged error, namely whether or not the court a quo erred in not finding that the amount of P63,855.25 which had been defrauded from the funds of the plaintiff corporation in the year 1917 by Federico Rodriguez Almela should be considered a loss incurred by that entity in the year 1928.

According to the stipulation of facts above-mentioned, on June 28, 1918 the plaintiff corporation transferred from its "Losses and Profits" account to its "Items in Suspense" account the amount of P63,831.71 as a loss actually sustained by the corporation. On December 21, of the same year, when it considered said amount as definitely lost, the corporation made it thus appear in its book by transferring it from its "Items in Suspense" account to that of "Losses and Profits"; but at the instance of the internal revenue agent-examiner, said entry was returned from the "Losses and Profits" account to that of "Items in Suspense" and entered in its book on December 31, 1918. The return of the defrauded sum to the "Items in Suspense" account at the instance of the internal revenue agent-examiner, prevented the plaintiff from excluding from its income tax returns for 1918 the amount swindled in 1917, and was able to do so only in the month of December, 1928, when it was definitely known that it was no longer possible to recover the said loss, charging it to the losses account and excluding it from its income tax returns for 1918. The Bureau of Internal Revenue not only ignored that deduction, but also in view of the returns filed by said plaintiff the Collector of Internal Revenue assessed the tax for that year which was paid under protest by plaintiff. Five years thereafter, or in 1923, the Collector of Internal Revenue claimed for the first time that said amount had been erroneously deducted as a loss sustained by plaintiff corporation in 1928 and should have been excluded from its income tax returns, which was filed in 1918, as a loss sustained in 1917, and demanded of the plaintiff corporation the payment of the additional tax on said sum, which plaintiff had to pay under protest as above-stated.

Defendant tried to detract from the validity and force of the opposition of his agent-examiner to the deduction of said loss from the income tax returns filed by the plaintiff corporation in the year 1918, alleging that said agent had no authority or power to interpose that opposition, and that the annotation which appears in the books of the plaintiff corporation, made on December 31, 1918, and which says: "Returned to the Debit of the first account (Items in Suspense)—amounts swindled by Federico R. Almela which we paid on June 28 last and charged to the respective accounts of this column (Losses and Profits) at the instance of the agent-examiner of the Bureau of Internal Revenue for the determination of the income tax for previous years—P63,831.77", is self-serving, that is, a statement made in favor of the plaintiff corporation itself, and hence not admissible.

As to the examination made by the internal revenue agent of the books of the plaintiff corporation in the year 1918, although it has been proved that agents-examiners have no authority to order the entry or nonentry, the inclusion or exclusion, the reduction or increase of any item in income tax returns filed by a taxpayer, but should make a report to the Collector of Internal Revenue of any anomaly which they may discover in said returns; yet it appearing, as it does, that said internal revenue agent opposed plaintiff corporation's deduction from its income tax returns for the year 1918 the loss it sustained on account of the estafa committed by its treasurer and accountant, and that plaintiff corporation believing in good faith that said internal revenue agent had authority to act as he did, eliminated said loss from the "Losses and Profits" account and returned it to that for "Items in Suspense", and did not deduct it until the year 1928 when the loss was definitely determined, said plaintiff corporation should not, in equity, be made to answer for the payment of the additional tax which has been collected from it after fifteen years have elapsed, notwithstanding that the loss was sustained in 1917 and should have been deducted from the income tax returns for 1918.

As to the annotation which appears on the books of the plaintiff corporation under date of December 31, 1918 in reference to the opposition of the aforementioned internal revenue agent to the deduction of the loss from the income for the year 1918, although said annotation favors the corporation, it is not inadmissible as evidence inasmuch as it is a contemporaneous entry made in the ordinary and regular course of business (sec. 328, Act No. 190).

It also appears in the stipulation of facts that from the year 1909 to the year 1911, the plaintiff corporation acquired 623 shares of stock of the Banco Espanol del Rio de la Plata, a corporation organized under the laws of Argentina, with a branch at London, England, of the value of \$100, Argentinian currency, per share, and with a total value of P101,195.91; that in the year 1925, by virtue of the articles of the aforementioned bank, as amended and approved by the national government of Argentina, dated March 7, 1924, and pursuant thereto, its capital stock was reduced from \$100,000,000 to \$25,000,000, divided into 250,000 ordinary shares of the par value of \$100 each, with the issuance of 250,000 new preferred shares of the total sum of \$25,000,000 with a par value of \$100 each being authorized. In view of said reduction of the capital stock of the bank, the original shares were cancelled and new shares of stock were issued on January 26, 1925 in the proportion of one (1) new share for every four (4) old ones. As a result of this arrangement, the 623 shares of stock of the plaintiff of the par value of \$100 each, were cancelled, and in their place 155¾ ordinary shares of the par value of \$100 each were issued. The difference between the original value of the old 623 shares, which amounted to P101,195.51, and that of 155¾ new shares amounting to P25,298.88, is P75,896.63 set forth as a loss in its income tax returns for the year 1928. The plaintiff corporation has paid the entire amount of the income tax for the year 1928 in accordance with the assessment made by the defendant, based upon the income tax returns filed by the plaintiff corporation for that year.

It likewise appears from the correspondence (Exhibits D, C, G, and S) presented by plaintiff corporation that the assets of the bank remained the same and that the only reorganization which was effected was the reduction of the

value of its capital stock.

The Department of the Treasury of the United States has issued the following opinion:

"In the case cited the \$5,000,000 capital stock issued in payment for the assets (tangible and intangible) of the first company is in fact of no greater actual value than is that of the \$500,000 of the first company, for the reason that in each case the value of the stock is based upon and supported by the same assets, and until the stock issued by the purchasing or reorganized company in payment for the assets of the first company is converted into cash or its equivalent, no taxable income will have been realized from the transaction. In other words the excess of the nominal par value of the stock of the selling company, the stock in both cases being supported by the same assets, does not constitute income within the meaning of the Federal income tax law." (Letter to A. G. Dickson, Philadelphia, Penh, signed by Commissioner W. H. Deborn, and dated May 3, 1915.)

"It has accordingly been held that no loss allowable as a deduction was sustained through an exchange of stock of the par value of \$100 for an equal number of shares of the par value of \$50 upon the reorganization of a company which had sustained an operation deficit.—Comm. Rec. 665, 5 C. B., 59, quoting the statutory provisions." (1927 Consolidated U. S. Income Tax Laws, p. 178.)

"Where upon the reorganization of a corporation, a stockholder received stock in the new corporation of a lesser aggregate par value than the stock which he held in the old corporation, no deductible loss was allowed the stockholder.—Appeal of Gordon, Dec. 475, 1 B. T. A. 1223. Appeal of Breuchaud, Dec. 571, 2 B. T. A. 162." (1927 Consolidated U. S. Income Tax Laws, p. 178.)

In accordance with the foregoing opinion, the difference resulting from the mere change in the number of shares of the same par value without reduction of the assets does not constitute a loss which must be deducted from the income subject to the corresponding income tax, when, unless the new shares are sold, it cannot be known whether reduction has resulted in a loss or not.

With respect to the fourth assignment of alleged error consisting in whether or not the court a quo erred in finding that the right of the Collector of Internal Revenue to assess and collect the income tax in question in the year 1933 has already prescribed, this court, in the case of Collector of Internal Revenue vs. Villegas (56 Phil., 554), held:

"It is therefore a matter established by the American jurisprudence that the three-year prescription refers to the discovery of erroneous, false, or fraudulent returns, and to tax assessments and their summary collection, but not to their collection through judicial channels. The motion filed by the Collector of Internal Revenue in this case, is equivalent to a judicial action for the collection of the accrued income tax. Therefore, the fact that the omission of the net income from the administrator's return was discovered after the period of three years from the filing of such return, on March 13, 1926, does not prevent the collection of the proper tax assessed after such discovery."

According to the doctrine above-cited, after three years have elapsed from the date on which income tax returns which have been found to be false, fraudulent or erroneous, may have been made, the Collector of Internal Revenue cannot make any summary collection through administrative methods, but must do so through judicial proceedings. Although the Collector of Internal Revenue had no power to make the summary collection which he effected administratively since three years had already elapsed when he discovered the erroneous returns, yet after said collection and after the plaintiff corporation has paid the additional tax under protest and brought this action to recover said tax, the administrative method for the collection of the tax becomes judicial, for which there is no prescription in accordance with the doctrine above-cited.

In view of the foregoing considerations, we are of the opinion and so hold: First, that a taxpayer who does not deduct his losses from his income tax returns for the year in which he may have sustained them on account of the opposition of an internal revenue agent-examiner to that deduction, but makes this ten years thereafter without

objection on the part of the Collector of Internal Revenue, should not, in equity, answer for the additional payment for that omission after the lapse of fifteen years for the reason that he has acted in good faith; second, that the difference in the total value of the shares of stock of a bank resulting from the reduction of the number of said shares which keep their par value, while the assets of the bank remain intact, cannot be considered as a loss until the assets are liquidated; and third, that although the Collector of Internal Revenue has no authority to make an administrative summary collection of the tax upon discovery of erroneous, false and fraudulent tax returns, after the three years fixed by law counting from the filing of said income tax returns have elapsed, when the taxpayer paid the additional tax under protest and brought the corresponding action to recover the protested additional payment, the collection became judicial and the right of the Collector of Internal Revenue to effect the collection through that means has not prescribed.

Wherefore, the judgment appealed from is affirmed as far it orders the refund of the additional tax collected under protest on account of the fact that no deduction was made of the loss of the sum of P63,855.27 from the income tax returns for the year 1917 when said loss was sustained; and is reversed in all other respects, without special pronouncement as to costs. So ordered.

Avanceña, C. J., Imperial, Diaz, Laurel, Concepcion, and Moran, JJ., concur.

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