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SECOND DIVISION

[G.R. No. 78953. July 31, 1991]

COMMISSIONER OF INTERNAL REVENUE, *petitioner*, *vs.* **MELCHOR J. JAVIER, JR. and THE COURT OF TAX APPEALS,** *respondents*.

SYLLABUS

1. **TAXATION; INCOME TAX; SURCHARGES FOR RENDERING A FALSE AND FRAUDULENT RETURN.** — Under the then Section 72 of the Tax Code (now Section 248 of the 1988 National Internal Revenue Code), a taxpayer who files a false return is liable to pay the fraud penalty of 50% of the tax due from him or of the deficiency tax in case payment has been made on the basis of the return filed before the discovery of the falsity or fraud.

2. **ID.; ID.; FILING OF FRAUDULENT RETURN; MUST BE ACTUAL AND INTENTIONAL THROUGH WILLFUL AND DELIBERATE MISLEADING OF THE GOVERNMENT AGENCY.** — In *Aznar v. Court of Tax Appeals* (L-20569, promulgated on August 23, 1974, 58 SCRA 519), fraud in relation to the filing of income tax return, was discussed in this manner: x x x The fraud contemplated by law is actual and not constructive. It must be intentional fraud, consisting of deception willfully and deliberately done or resorted to in order to induce another to give up some legal right. Negligence, whether slight or gross, is not equivalent to the fraud with intent to evade the tax contemplated by law. It must amount to intentional wrong-doing with the sole object of avoiding the tax. It necessarily follows that a mere mistake cannot be considered as fraudulent intent, and if both petitioner and respondent Commissioner of Internal Revenue committed mistakes in making entries in the returns and in the assessment, respectively, under the inventory method of determining tax liability, it would be unfair to treat the mistakes of the petitioner as tainted with fraud and those of the respondent as made in good faith. Fraud is never imputed and the courts never sustain findings of fraud upon circumstances which, at most, create

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only suspicion and the mere understatement of a tax is not itself proof of fraud for the purpose of tax evasion.

3. **ID.; ID.; ID.; NOT PRESENT IN CASE AT BAR.** — In the case at bar, there was no actual and intentional fraud through willful and deliberate misleading of the government agency concerned, the Bureau of Internal Revenue, headed by the herein petitioner. The government was not induced to give up some legal right and place itself at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities because Javier did not conceal anything. Error or mistake of law is not fraud. The petitioner's zealousness to collect taxes from the unearned windfall to Javier is highly commendable. Unfortunately, the imposition of the fraud penalty in this case is not justified by the extant facts. Javier may be guilty of swindling charges, perhaps even for greed by spending most of the money he received, but the records lack a clear showing of fraud committed because he did not conceal the fact that he had received an amount of money although it was a "subject of litigation." As ruled by respondent Court of Tax Appeals, the 50% surcharge imposed as fraud penalty by the petitioner against the private respondent in the deficiency assessment should be deleted.

DECISION

SARMIENTO, *J.*:

Central in this controversy is the issue as to whether or not a taxpayer who merely states as a footnote in his income tax return that a sum of money that he erroneously received and already spent is the subject of a pending litigation and there did not declare it as income is liable to pay the 50% penalty for filing a fraudulent return.

This question is the subject of the petition for review before the Court of the portion of the Decision[1] dated July 27, 1983 of the Court of Tax Appeals (CTA) in C.T.A. Case No. 3393,

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[1] Annex "A", Petition; Presiding Judge Amante Filler, *Ponente*, Associate Judge Alex Z. Reyes, *Concurring*; and Judge Constante C. Roaquin, *Concurring and Dissenting.*

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entitled, "*Melchor J. Javier, Jr. vs. Ruben B. Ancheta*, in his capacity as Commissioner of Internal Revenue," which orders the deletion of the 50% surcharge from Javier's deficiency income tax assessment on his income for 1977.

The respondent CTA in a Resolution[2] dated May 25, 1987, denied the Commissioner's Motion for Reconsideration[3] and Motion for New Trial[4] on the deletion of the 50% surcharge assessment or imposition.

The pertinent facts as are accurately stated in the petition of private respondent Javier in the CTA and incorporated in the assailed decision now under review, read as follows:

x x x x x x x x x

2. That on or about June 3, 1977, Victoria L. Javier, the wife of the petitioner (private respondent herein), received from the Prudential Bank and Trust Company in Pasay City the amount of US$999,973.70 remitted by her sister, Mrs. Dolores Ventosa, through some banks in the United States, among which is Mellon Bank, N.A.

3. That on or about June 29, 1977, Mellon Bank, N.A. filed a complaint with the Court of First Instance of Rizal (now Regional Trial Court), (docketed as Civil Case No. 26899), against the petitioner (private respondent herein), his wife and other defendants, claiming that its remittance of US$1,000,000.00 was a clerical error and should have been US$1,000.00 only, and praying that the excess amount of US$999,000.00 be returned on the ground that the defendants are trustees of an implied trust for the benefit of Mellon Bank with the clear, immediate, and continuing duty to return the said amount from the moment it was received.

4. That on or about November 5, 1977, the City Fiscal of Pasay City filed an Information with the then Circuit Criminal Court (docketed as CCC-VII-3369-P.C.) charging the petitioner (private respondent herein) and his wife with the crime of estafa, alleging that they misappropriated, misapplied, and converted to their own personal

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[2] Annex "D", Petition.

[3] Annex "B", Petition.

[4] Annex "C", Petition.

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use and benefit the amount of US$999,000.00 which they received under an implied trust for the benefit of Mellon Bank and as a result of the mistake in the remittance by the latter.

5. That on March 15, 1978, the petitioner (private respondent herein) filed his Income Tax Return for the taxable year 1977 showing a gross income of ₱53,053.38 and a net income of ₱48,053.88 and stating in the footnote of the return that "Taxpayer was recipient of some money received from abroad which he presumed to be a gift but turned out to be an error and is now subject of litigation."

6. That on or before December 15, 1980, the petitioner (private respondent herein) received a letter from the acting Commissioner of Internal Revenue dated November 14, 1980, together with income assessment notices for the years 1976 and 1977, demanding that petitioner (private respondent herein) pay on or before December 15, 1980 the amount of ₱1,615.96 and ₱9,287,297.51 as deficiency assessments for the years 1976 and 1977 respectively. x x x

7. That on December 15, 1980, the petitioner (private respondent herein) wrote the Bureau of Internal Revenue that he was paying the deficiency income assessment for the year 1976 but denying that he had any undeclared income for the year 1977 and requested that the assessment for 1977 be made to await final court decision on the case filed against him for filing an allegedly fraudulent return. x x x

8. That on November 11, 1981, the petitioner (private respondent herein) received from Acting Commissioner of Internal Revenue Romulo Villa a letter dated October 8, 1981 stating in reply to his December 15, 1980 letter-protest that "the amount of Mellon Bank's erroneous remittance which you were able to dispose, is definitely taxable."x x x[5]

The Commissioner also imposed a 50% fraud penalty against Javier.

Disagreeing, Javier filed an appeal[6] before the respondent Court of Tax Appeals on December 10, 1981.

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[5] Court of Tax Appeals Decision, Case No. 3393, promulgated on July 27, 1983, 2-3; *Rollo*, 35-36.

[6] Annex "F", Petition.

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The respondent CTA, after the proper proceedings, rendered the challenged decision. We quote the concluding portion:

> We note that in the deficiency income tax assessment under consideration, respondent (petitioner here) further requested petitioner (private respondent here) to pay 50% surcharge as provided for in Section 72 of the Tax Code, in addition to the deficiency income tax of ₱4,888,615.00 and interest due thereon. Since petitioner (private respondent) filed his income tax return for taxable year 1977, the 50% surcharge was imposed, in all probability, by respondent (petitioner) because he considered the return filed false or fraudulent. This additional requirement, to our mind, is much less called for because petitioner (private respondent), as stated earlier, reflected in his 1977 return as footnote that "Taxpayer was recipient of some money received from abroad which he presumed to be gift but turned out to be an error and is now subject of litigation."
>
> From this, it can hardly be said that there was actual and intentional fraud, consisting of deception willfully and deliberately done or resorted to by petitioner (private respondent) in order to induce the Government to give up some legal right, or the latter, due to a false return, was placed at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities. (*Aznar vs. Court of Tax Appeals*, L-20569, August 23, 1974, 56 [sic] SCRA 519), because petitioner literally "laid his cards on the table" for respondent to examine. Error or mistake of fact or law is not fraud. (*Insular Lumber vs. Collector*, L-7100, April 28, 1956). Besides, Section 29 is not too plain and simple to understand. Since the question involved in this case is of first impression in this jurisdiction, under the circumstances, the 50% surcharge imposed in the deficiency assessment should be deleted.[7]

The Commissioner of Internal Revenue, not satisfied with the respondent CTA's ruling, elevated the matter to us, by the present petition, raising the main issue as to:

> WHETHER OR NOT PRIVATE RESPONDENT IS LIABLE FOR THE 50% FRAUD PENALTY?[8]

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[7] Court of Tax Appeals Decision, *supra*; *rollo*, 47-49.

[8] Petition, 7; *rollo*, 22.

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On the other hand, Javier candidly stated in his Memorandum,[9] that he "did not appeal the decision which held him liable for the basic deficiency income tax (excluding the 50% surcharge for fraud)." However, he submitted in the same memorandum "that the issue may be raised in the case not for the purpose of correcting or setting aside the decision which held him liable for deficiency income tax, but only to show that there is no basis for the imposition of the surcharge." This subsequent disavowal therefore renders moot and academic the posturings articulated in his Comment[10] on the non-taxability of the amount he erroneously received and the bulk of which he had already disbursed. In any event, an appeal at that time (of the filing of the Comments) would have been already too late to be seasonable.

The petitioner, through the office of the Solicitor General, stresses that:

x x x x x x x x x

The record however is not ambivalent, as the record clearly shows that private respondent is self-convinced, and so acted, that he is the beneficial owner, and of which reason is liable to tax. Put another way, the studied insinuation that private respondent may not be the beneficial owner of the money or income flowing to him as enhanced by the studied claim that the amount is "subject of litigation" is belied by the record and clearly exposed as a fraudulent ploy, as witness what transpired upon receipt of the amount.

Here, it will be noted that the excess in the amount erroneously remitted by MELLON BANK for the amount of private respondent's wife was $999,000.00 after opening a dollar account with Prudential Bank in the amount of $999,993.70, private respondent and his wife, with haste and dispatch, within a span of eleven (11) electric days, specifically from June 3 to June 14, 1977, effected a total massive withdrawal from the said dollar account in the sum of $975,000.00 or ₱7,020,000.00 x x x.[11]

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[9] Respondents' Memorandum, *rollo*, 156.

[10] *Rollo*, 120.

[11] *Id.*, 25-26.

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In reply, the private respondent argues:

x x x x x x x x x

The petitioner contends that the private respondent committed fraud by not declaring the "mistaken remittance" in his income tax return and by merely making a footnote thereon which read: "Taxpayer was the recipient of some money from abroad which he presumed to be a gift but turned out to be an error and is now subject of litigation." It is respectfully submitted that the said return was not fraudulent. The footnote was practically an invitation to the petitioner to make an investigation, and to make the proper assessment.

The rule in fraud cases is that the proof "must be clear and convincing" (*Griffiths v. Comm.*, 50 F [2d] 782), that is, it must be stronger than the "mere preponderance of evidence" which would be sufficient to sustain a judgment on the issue of correctness of the deficiency itself apart from the fraud penalty. (Frank A. Neddas, 40 BTA 572). The following circumstances attendant to the case at bar show that in filing the questioned return, the private respondent was guided, not by that "willful and deliberate intent to prevent the Government from making a proper assessment" which constitute fraud, but by an honest doubt as to whether or not the "mistaken remittance" was subject to tax.

First, this Honorable Court will take judicial notice of the fact that so-called "million dollar case" was given very, very wide publicity by media; and only one who is not in his right mind would have entertained the idea that the BIR would not make an assessment if the amount in question was indeed subject to the income tax.

Second, as the respondent Court ruled, "the question involved in this case is of first impression in this jurisdiction" (See p. 15 of Annex "A" of the Petition). Even in the United States, the authorities are not unanimous in holding that similar receipts are subject to the income tax. It should be noted that the decision in the Rutkin case is a five-to-four decision; and in the very case before this Honorable Court, one out of three Judges of the respondent Court was of the opinion that the amount in question is not taxable. Thus, even without the footnote, the failure to declare the "mistaken remittance" is not fraudulent.

Third, when the private respondent filed his income tax return on March 15, 1978 he was being sued by the Mellon Bank for the return

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of the money, and was being prosecuted by the Government for estafa committed allegedly by his failure to return the money and by converting it to his personal benefit. The basic tax amounted to ₱4,899,377.00 (See p. 6 of the Petition) and could not have been paid without using part of the mistaken remittance. Thus, it was not unreasonable for the private respondent to simply state in his income tax return that the amount received was still under litigation. If he had paid the tax, would that not constitute estafa for using the funds for his own personal benefit? and would the Government refund it to him if the courts ordered him to refund the money to the Mellon Bank?[12]

x x x x x x x x x

Under the then Section 72 of the Tax Code (now Section 248 of the 1988 National Internal Revenue Code), a taxpayer who files a false return is liable to pay the fraud penalty of 50% of the tax due from him or of the deficiency tax in case payment has been made on the basis of the return filed before the discovery of the falsity or fraud.

We are persuaded considerably by the private respondent's contention that there is no fraud in the filing of the return and agree fully with the Court of Tax Appeals' interpretation of Javier's notation on his income tax return filed on March 15, 1978 thus: "Taxpayer was the recipient of some money from abroad which he presumed to be a gift but turned out to be an error and is now subject of litigation"; that it was an "error or mistake of fact or law" not constituting fraud, that such notation was practically an invitation for investigation and that Javier had literally "laid his cards on the table."[13]

In *Aznar v. Court of Tax Appeals*,[14] fraud in relation to the filing of income tax return, was discussed in this manner:

x x x The fraud contemplated by law is actual and not constructive. It must be intentional fraud, consisting of deception willfully and

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[12] Respondents' Memorandum, 10-11; *rollo*, 164-165.

[13] *Rollo*, 47-48.

[14] L-20569, promulgated on August 23, 1974, 58 SCRA 519.

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deliberately done or resorted to in order to induce another to give up some legal right. Negligence, whether slight or gross, is not equivalent to the fraud with intent to evade the tax contemplated by law. It must amount to intentional wrong-doing with the sole object of avoiding the tax. It necessarily follows that a mere mistake cannot be considered as fraudulent intent, and if both petitioner and respondent Commissioner of Internal Revenue committed mistakes in making entries in the returns and in the assessment, respectively, under the inventory method of determining tax liability, it would be unfair to treat the mistakes of the petitioner as tainted with fraud and those of the respondent as made in good faith.

Fraud is never imputed and the courts never sustain findings of fraud upon circumstances which, at most, create only suspicion and the mere understatement of a tax is not itself proof of fraud for the purpose of tax evasion.[15]

A "fraudulent return" is always an attempt to evade a tax, but a merely "false return" may not be. *Rick v. U.S.*, App. D.C., 161 F. 2d 897, 898.[16]

In the case at bar, there was no actual and intentional fraud through willful and deliberate misleading of the government agency concerned, the Bureau of Internal Revenue, headed by the herein petitioner. The government was not induced to give up some legal right and place itself at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities because Javier did not conceal anything. Error or mistake of law is not fraud. The petitioner's zealousness to collect taxes from the unearned windfall to Javier is highly commendable. Unfortunately, the imposition of the fraud penalty in this case is not justified by the extant facts. Javier may be guilty of swindling charges, perhaps even for greed by spending most of the money he received, but the records lack a clear showing of fraud committed because he did not conceal the fact that he had received an amount of money although it was a "subject

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[15] *Yutivo Sons Hardware Co. vs. Court of Tax Appeals*, L-13203, promulgated on January 28, 1961, 1 SCRA 160.

[16] *WORDS AND PHRASES;* (1958 ed.), Vol. 17A, 210.

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of litigation." As ruled by respondent Court of Tax Appeals, the 50% surcharge imposed as fraud penalty by the petitioner against the private respondent in the deficiency assessment should be deleted.

WHEREFORE, the petition is DENIED and the decision appealed from the Court of Tax Appeals is AFFIRMED. No costs.

SO ORDERED.

Melencio-Herrera (Chairperson), Padilla, and *Regalado, JJ.*, concur.

Paras, J., no part. Participated in CA involving same accused in bank incident.

EN BANC

[G.R. No. 85670. July 31, 1991]

ROGELIO A. TRIA, *petitioner, vs.* **CHAIRMAN PATRICIA A. STO. TOMAS, CIVIL SERVICE COMMISSION, RET. BRIG. GEN. JOSE T. ALMONTE, RET. COL. ERNESTO P. RAVINA and RET. GEN. MIGUEL M. VILLAMOR,** *respondents.*

SYLLABUS

1. **POLITICAL LAW; CONSTITUTIONAL LAW; CIVIL SERVICE; TWO-FOLD EFFECTS OF CHARACTERIZING A POSITION AS PRIMARILY CONFIDENTIAL.** — The effects of characterizing a position as "primarily confidential" are two-fold: firstly, such characterization renders inapplicable the ordinary requirement of filling up a position in the Civil Service on the basis of merit and fitness as determined by competitive examinations; and secondly, while the 1987 Constitution does not exempt such positions from the operation of the principle set out in Article IX (B), Section 2 (3) of the same Constitution that "no officer or employee of the Civil