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quam pereat,' that the courts should, if reasonably possible to do so without violence to the spirit and language of an act, so interpret the statute to give it efficient operation and effect as a whole. An interpretation should, if possible, be avoided, under which a statute or provision being construed is defeated, or as otherwise expressed, nullified, destroyed, emasculated, repealed, explained away, or rendered insignificant, meaningless, inoperative, or nugatory."[14]

ACCORDINGLY, the judgment of the Court of Tax Appeals of November 20, 1961 is affirmed, at petitioner's cost.

Concepcion, C.J., Dizon, Zaldivar, Fernando, Capistrano, Teehankee and *Barredo, JJ.*, concur.

Makalintal and *Sanchez, JJ.*, did not take part.

Reyes, J.B.L., J., is on official leave.

[G.R. No. L-21551. September 30, 1969]

FERNANDEZ HERMANOS, INC., petitioner, *vs.* COMMISSIONER OF INTERNAL REVENUE and COURT OF TAX APPEALS, respondents.

[G.R. No. L-21557. September 30, 1969]

COMMISSIONER OF INTERNAL REVENUE, petitioner, *vs.* FERNANDEZ HERMANOS, INC. and COURT OF TAX APPEALS, respondents.

[G.R. No. L-24972. September 30, 1969]

COMMISSIONER OF INTERNAL REVENUE, petitioner, *vs.* FERNANDEZ HERMANOS, INC. and the COURT OF TAX APPEALS, respondents.

[G.R. No. L-24978. September 30, 1969]

FERNANDEZ HERMANOS, INC., petitioner, *vs.* THE COMMISSIONER OF INTERNAL REVENUE, and HON. ROMAN A. UMALI, COURT OF TAX APPEALS, respondents.

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[14] 50 Am. Jur. 358-359.

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SYLLABUS

1. TAXATION; NATIONAL INTERNAL REVENUE CODE; INCOME TAX ALLOWABLE DEDUCTIONS; WORTHLESS SECURITIES; WRITING-OFF PROPER IN INSTANT CASE.— We find no reason to disturb the Tax Court's allowance of the taxpayer's writing-off as worthless securities in its 1950 return the sum of ₱8,050.00 representing the cost of shares of stock of Mati Lumber Co. acquired by the taxpayer on January 1, 1948. There was adequate basis for the writing-off of the stock as worthless securities. As found by the Tax Court, the Mati Lumber Co. ceased operation in 1949 when its manager and owner left for Spain where he subsequently died. When the company ceased to operate, it had no assets. Assuming that the Company would later somehow realize some proceeds from its sawmill and equipment, which were still existing as claimed by the Commissioner, and that such proceeds would later be distributed to its stockholders such as the taxpayer, the amount so received by the taxpayer would then properly be reportable as income of the taxpayer on the year it is received.

2. ID.; ID.; ID.; ID.; BAD DEBT, WHEN CONSIDERED.— The Tax Court's disallowance of the writing-off in 1951 as a loss or bad debt the sum of ₱353,134.25, which it had advanced or loaned to Palawan Manganese Mines, Inc., was proper. The Solicitor General has rightly pointed out that the taxpayer has taken an "ambiguous position" and "has not definitely taken a stand on whether the amount involved is claimed as losses or as bad debts but insists that it is either a loss or a bad debt." We sustain the government's position that the advances made by the taxpayer to its 100% subsidiary, Palawan Manganese Mines, Inc. amounting to ₱587,308.07 as of 1951 were investments and not loans. The evidence on record shows that the board of directors of the two companies since August, 1945 were identical and that the only capital of Palawan Manganese Mines, Inc. is the amount of ₱100,000.00 entered in the taxpayer's balance sheet as its investment in its subsidiary company. This fact explains the liberality with which the taxpayer made such large advances to the subsidiary, despite the latter's admittedly poor financial condition.

3. ID.; ID.; ID.; ID.; DEBT OR INVESTMENT OF CORPORATION NOT WORTHLESS IF CORPORATION IS STILL IN OPERATION.— The Tax Court correctly held that the subsidiary company was still in operation in 1951 and 1952 and the taxpayer continued to give it

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advances in those years, and therefore, the alleged debt or investment could not properly be considered worthless and deductible in 1951, as claimed by the taxpayer. Furthermore, neither under Section 30(d)(2) of our Tax Code providing for deduction by corporations of losses actually sustained and charged off during the taxable year nor under Section 30 (e)(1) thereof providing for deduction of bad debts actually ascertained to be worthless and charged off within the taxable year, can there be a partial writing-off of a loss or bad debt, as was sought to be done here by the taxpayer. For such losses or bad debts must be ascertained to be so and written-off during the taxable year, are therefore deductible in full or not at all, in the absence of any express provision in the Tax Code authorizing partial deductions.

4. ID.; ID.; ID.; ID.; LOSSES; DISALLOWANCE THEREOF PROPER IN INSTANT CASE.— The Court sustains the Tax Court's disallowance of the sums of ₱8,989.76 and ₱27,732.66 spent by the taxpayer for the operation of its Balamban coal mine in Cebu in 1950 and 1951, respectively, and claimed as losses in the taxpayer's returns for said years. The Tax Court correctly held that the losses "are deductible in 1952, when the mines were abandoned, and not in 1950 and 1951, when they were still in operation." The taxpayer's claim that these expenditures should be allowed as losses for the corresponding years that they were incurred, because it made no sales of coal during said years, since the promised road or outlet through which the coal could be transported from the mines to the provincial road was not constructed, cannot be sustained. Some definite event must fix the time when the loss is sustained, and here it was the event of actual abandonment of the mines in 1952.

5. ID.; ID.; ID.; ID.; LOSSES BY INVENTORY METHOD; DISALLOWANCE OF LOSSES THEREOF, NOT PROPER.— Where respondent Commissioner concedes that under Section 100 of Revenue Regulations No. 2, it does not specify how the inventories are to be made and the Tax Court is satisfied with the evidence presented by the taxpayer . . . which merely consisted of an alleged physical count of the number of the livestock in Hacienda Dalupiri for the years involved and the method adopted by the taxpayer as a farmer breeding livestock, reporting on the basis of receipts and disbursements, there is no compelling reason to disturb the ruling of the Tax Court overuling the Commissioner's disallowance of losses in Hacienda Dalupiri (1950 to 1954) and Hacienda Samal (1951-1952).

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6. ID.; ID.; ID.; ID.; DEPRECIATION OF BUILDINGS; ANNUAL RATE OF 10% DEPRECIATION, EXCESSIVE; DISALLOWANCE PROPER.— During the year 1950 to 1954, the taxpayer claimed a depreciation allowance for its buildings at the annual rate of 10%. The Commissioner claimed that the reasonable depreciation rate is only 3% annually. We sustain the Tax Court's finding that the taxpayer did not submit adequate proof of the correctness of the taxpayer's claim that the depreciable assets or buildings in question had a useful life only of 10 years so as to justify its 10% depreciation per annum claim, such finding being supported by the record. The taxpayer's contention that it has many zero or one-peso assets, support the Commissioner's position that a 10% annual depreciation rate was excessive.

7. ID.; ID.; ID.; INCREASE IN NET WORTH NOT TAXABLE IF NOT DUE TO TAXABLE RECEIPT.— Where it is shown that the increases in the taxpayer's net worth were not the result of the receipt by it of unreported or unexplained taxable income but were merely the result of the correction of errors in its entries in its books relating to its indebtedness to certain creditors, which had been erroneously overstated or listed as outstanding when they had in fact duly paid, these increases in the taxpayer's net worth were not taxable increases in net worth.

8. ID.; ID.; ID.; ALLEGED UNREPORTED GAIN FROM SALE OF REAL PROPERTY, NO BASIS.— Where it was sufficiently proved from the taxpayer's books that after acquiring the property in 1926 for ₱11,852.74, the gain derived from the sale of the said property for ₱60,000.00 was correctly reported by the taxpayer at ₱37,000.00.

9. ID.; ID.; ID.; CAPITAL INVESTMENT, NOT BASIS FOR DEPLETION.— The taxpayer insists in this appeal that it could use as a method for depletion under the pertinent provision of the Tax Code its "capital investment" representing the alleged value of its contractual rights and titles to mining claims in the sum of ₱242,408.10 and thus deduct outright one-fifth (1/5) of this "Capital investment" every year, regardless of whether it had actually mined the product and sold the products. HELD: The alleged "capital investment" method invoked by the taxpayer is not a method of depletion, but the Tax Code provision, prior to its amendment by Section 1 of Republic Act No. 2698, which took effect on June 18, 1960, expressly provided that "when the allowances shall equal capital invested . . .

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no further allowances shall be made;" in other words, the "capital investment" was but the limitation of the amount of depletion that could be claimed. The outright deduction by the taxpayer of 1/5 of the cost of the mines, as if it were a "straight line" rate of depreciation was correctly held by the Tax Court not to be authorized by the Tax Code.

10. ID.; ID.; ASSESSMENT AND COLLECTION OF INCOME TAX; PRESCRIPTION; ACTION FOR COLLECTION IN INSTANT CASE HAS NOT PRESCRIBED.— In the present case, regardless of whether the assessments were made on February 24 and 27, 1956, as claimed by the Commissioner, or on December 27, 1955 as claimed by the taxpayer, the government's right to collect the taxes due has clearly not prescribed, as the taxpayer's appeal or petition for review was filed with the Tax Court on May 4, 1960, with the Commissioner filing on May 20, 1960 his answer with a prayer for payment of the taxes due, long before the expiration of the five-year period to effect collection by judicial action counted from the date of assessment.

APPEARANCES OF COUNSEL

Rafael Dinglasan for respondent.

Solicitor General Arturo A. Alafriz, Assistant Solicitor General Felicisimo R. Rosete and *Special Attorney Virgilio G. Zaldajeno* for respondent Arive.

DECISION

TEEHANKEE, *J.*:

These four appeals involve two decisions of the Court of Tax Appeals determining the taxpayer's income tax liability for the years 1950 to 1954 and for the year 1957. Both the taxpayer and the Commissioner of Internal Revenue, as petitioner and respondent in the cases *a quo* respectively, appealed from the Tax Court's decisions, insofar as their respective contentions on particular tax items were therein resolved against them. Since the issues raised are inter-related, the Court resolves the four appeals in this joint decision.

Cases L-21551 and L-21557

The taxpayer, Fernandez Hermanos, Inc. is a domestic corporation organized for the principal purpose of engaging in

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business as an "investment company" with main office at Manila. Upon verification of the taxpayer's income tax returns for the period in question, the Commissioner of Internal Revenue assessed against the taxpayer the sums of ₱13,414.00, ₱119,613.00, ₱11,698.00, ₱6,887.00 and ₱14,451.00 as alleged deficiency income taxes for the years 1950, 1951, 1952, 1953 and 1954, respectively. Said assessments were the result of alleged discrepancies found upon the examination and verification of the taxpayer's income tax returns for the said years, summarized by the Tax Court in its decision of June 10, 1963 in CTA Case No. 787, as follows:

"1. Losses --

Losses in Mati Lumber Co. (1950)	₱ 8,050.00
b. Losses in or bad debts of Palawan Manganese Mines, Inc. (1951)	353,134.25
c. Losses in Balamban Coal Mines -- 1950	8,989.76
(1951)	27,732.66
d. Losses in Hacienda Dalupiri --	
1950	17,418.95
1951	29,125.82
1952	26,744.81
1953	21,932.62
1954	42,938.56
e. Losses in Hacienda Samal --	
1951	8,380.40
1952	7,621.73
2. Excessive depreciation of Houses --	
1950	₱ 8,180.40
1951	8,768.11
1952	18,002.16
1953	13,665.25
1954	29,314.98

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3. Taxable increase in net worth --
   1950 ..... ₱30,050.00
   1951 ..... 1,382.85

4. Gain realized from sale of real property in 1950 ..... ₱11,147.26"[1]

The Tax Court sustained the Commissioner's disallowances of Item 1, sub-items (b) and (c) and Item 2 of the above summary, but overruled the Commissioner's disallowances of all the remaining items. It therefore modified the deficiency assessments accordingly, found the total deficiency income taxes due from the taxpayer for the years under review to amount to ₱123,436.00 instead of ₱166,063.00 as originally assessed by the Commissioner, and rendered the following judgment:

"RESUME

1950	₱ 2,748.00
1951	108,724.00
1952	3,600.00
1953	2,501.00
1954	5,863.00
Total	₱123,436.00

"WHEREFORE, the decision appealed from is hereby modified and petitioner is ordered to pay the sum of ₱123,436.00 within 30 days from the date this decision becomes final. If the said period, or any part thereof, is not paid within said period, there shall be added to the unpaid amount a surcharge of 5%, plus interest as provided in Section 51 of the National Internal Revenue code, as amended. With costs against petitioner." (Pp. 75, 76, Taxpayer's Brief as appellant)

Both parties have appealed from the respective adverse rulings against them in the Tax Court's decision. Two main issues are raised by the parties: first, the correctness of the Tax Court's rulings with respect to the disputed items of disallowances enumerated in the Tax Court's summary reproduced above, and second, whether or not the government's right to collect the deficiency income taxes in question has already prescribed.

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[1] ayer's Brief as appellant, p. 57-59.

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On the first issue, we will discuss the disputed items of disallowances *seriatim*.

1. *Re allowances/disallowances of losses.*

(a) *Allowances of losses in Mati Lumber Co. (1950)*— The Commissioner of Internal Revenue questions the Tax court's allowance of the taxpayer's writing off as worthless securities in its 1950 return the sum of ₱8,050.00 representing the cost of shares of stock of Mati Lumber Co. acquired by the taxpayer on January 1, 1948, on the ground that the worthlessness of said stock in the year 1950 had not been clearly established. The Commissioner contends that although the said Company was no longer in operation in 1950, it still had its sawmill and equipment which must be of considerable value. The Tax Court, however, found that "the company ceased operations in 1949 when its Manager and owner, a certain Mr. Rocamora, left for Spain where he subsequently died. When the company ceased to operate, it had no assets, in other words, completely insolvent. This information as to the insolvency of the Company—reached (the taxpayer) in 1950," when it properly claimed the loss as a deduction in its 1950 tax return, pursuant to Section 30(d) (4) (b) or Section 30(e) (3) of the National Internal Revenue Code.[2]

We find no reason to disturb this finding of the Tax Court. There was adequate basis for the writing-off of the stock as worthless securities. Assuming that the Company would later somehow realize some proceeds from its sawmill and equipment, which were still existing as claimed by the Commissioner, and that such proceeds would later be distributed to its stockholders such as the taxpayer, the amount so received by the taxpayer would then properly be reportable as income of the taxpayer on the year it is received.

(b) *Disallowance of losses in or bad debts of Palawan Manganese Mines, Inc.* (1951).— The taxpayer appeals from the

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[2] CTA decision in Case 787, Taxpayer's Brief as appellant, p. 62

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Tax Court's disallowance of its writing off in 1951 as a loss or bad debt the sum of ₱353,134.25, which it had advanced or loaned to Palawan Manganese Mines, Inc. The Tax Court's findings on this item follow:

"Sometime in 1945, Palawan Manganese Mines, Inc., the controlling stockholders of which are also the controlling stockholders of petitioner corporation, requested financial help from petitioner to enable it to resume its mining operations in Coron, Palawan. The request for financial assistance was readily and unanimously approved by the Board of Directors of petitioner, and thereafter a memorandum agreement was executed on August 12, 1945, embodying the terms and conditions under which the financial assistance was to be extended, the pertinent provisions of which are as follows:

'WHEREAS, the FIRST PARTY, by virtue of its resolution adopted on August 10, 1945, has agreed to extend to the SECOND PARTY the requested financial help by way of accommodation advances and for this purpose has authorized its President, Mr. Ramon J. Fernandez to cause the release of funds to the SECOND PARTY.

'WHEREAS, to compensate the FIRST PARTY for the advances that it has agreed to extend to the SECOND PARTY, the latter has agreed to pay to the former fifteen per centum (15%) of its net profits.

'NOW THEREFORE, for and in consideration of the above premises, the parties hereto have agreed and convenanted that in consideration of the financial help to be extended by the FIRST PARTY to the SECOND PARTY to enable the latter to resume its mining operations in Coron, Palawan, the SECOND PARTY has agreed and undertaken as it hereby agrees and undertakes to pay to the FIRST PARTY fifteen per centum (15%) of its net profits.' (Exh. H-2)

"Pursuant to the agreement mentioned above, petitioner gave to Palawan Manganese Mines, Inc. yearly advances starting from 1945, which advances amounted to ₱587,308.07 by the end of 1951. Despite these advances and the resumption of operations by Palawan Manganese Mines, Inc., it continued to suffer losses. By 1951, petitioner became convinced that those advances could no longer be recovered. While it continued to give advances, it decided to write off as worthless the sum of ₱353,134.25. This amount 'was arrived at on the basis of the total of advances made from 1945 to

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1949 in the sum of ₱483,981.39, from which amount the sum of ₱85,647.14 had to be deducted, the latter sum representing its pre-war assets. (t.s. n., pp. 136-139, Id.).' (Page 4, Memorandum for Petitioner.) Petitioner decided to maintain the advances given in 1950 and 1951 in the hope that it might be able to recover the same, as in fact it continued to give advances up to 1952. From these facts, and as admitted by petitioner itself, Palawan Manganese Mines, Inc. was still in operation when the advances corresponding to the years 1945 to 1949 were written off the books of petitioner. Under the circumstances, was the sum of ₱353,134.25 properly claimed by petitioner as deduction in its income tax return for 1951, either as losses or bad debts?

"It will be noted that in giving advances to Palawan Manganese Mines, Inc. petitioner did not expect to be repaid. It is true that some testimonial evidence was presented to show that there was some agreement that the advances would be repaid, but no documentary evidence was presented to this effect. The memorandum agreement signed by the parties appears to be very clear that the consideration for the advances made by petitioner was 15% of the net profits of Palawan Manganese Mines, Inc. In other words, if there were no earnings or profits, there was no obligation to repay those advances. It has been held that the voluntary advances made without expectation of repayment do not result in deductible losses. 1955 PH Fed. Taxes, Par. 13,329, citing W.F. Young, Inc. *v.* Comm., 120 F 2d. 159, 27 AFTR 395; George B. Markle, 17 T C. 1593.

"Is the said amount deductible as a bad debt? As already stated, petitioner gave advances to Palawan Manganese Mines, Inc. without expection of repayment. Petitioner could not sue for recovery under the memorandum agreement because the obligation of Palawan Manganese Mines, Inc. was to pay petitioner 15% of its net profits, not the advances. No bad debt could arise where there is no valid and subsisting debt.

"Again, assuming that in this case there was a valid and subsisting debt and that the debtor was in capable of paying the debt in 1951, when petitioner wrote off the advances and deducted the amount in its return for said year, yet the debt is not deductible in 1951 as a worthless debt. It appears that the debtor was still in operation in 1951 and 1952, as petitioner continued to give advances in those years. It has been held that if the debtor corporation, although losing money or insolvent, was still operating at the end of the taxable year, the debt is not considered worthless and therefore not deductible."[3]

[3] CTA decision in Case 787, Taxpayer's Brief as appellant, pp. 63-66.

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The Tax Court's disallowance of the write-off was proper. The Solicitor General has rightly pointed out that the taxpayer has taken an "ambiguous position" and "has not definitely taken a stand on whether the amount involved is claimed as losses or as bad debts but insists that it is either a loss or a bad debt."[4] We sustain the government's position that the advances made by the taxpayer to its 100% subsidiary, Palawan Manganese Mines, Inc. amounting to ₱587,308.07 as of 1951 were investments and not loans.[5] The evidence on record shows that the board of directors of the two companies since August, 1945 were identical and that the only capital of Palawan Manganese Mines, Inc. is the amount of ₱100,000.00 entered in the taxpayer's balance sheet as its investment in its subsidiary company.[6] This fact explains the liberality with which the taxpayer made such large advances to the subsidiary, despite the latter's admittedly poor financial condition.

The taxpayer's contention that its advances were loans to its subsidiary as against the Tax Court's finding that under their memorandum agreement, the taxpayer did not expect to be repaid, since if the subsidiary had no earnings, there was no obligation to repay those advances, becomes immaterial, in the light of our resolution of the question. The Tax Court correctly held that the subsidiary company was still in operation in 1951 and 1952 and the taxpayer continued to give it advances in those years, and therefore, the alleged debt or investment could not properly be considered worthless and deductible in 1951, as claimed by the taxpayer. Furthermore, neither under Section 30(d) (2) of our Tax Code providing for deduction by corporations of losses actually sustained and charged off during the taxable year nor under Section 30(e) (1) thereof providing for deduction of bad debts actually ascertained to be worthless and charged off within the

[4] Commissioner's Brief as appellee, p. 9.

[5] *Idem*, p. 18.

[6] *Idem*, p. 18.

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taxable year, can there be a partial writing off of a loss or bad debt, as was sought to be done here by the taxpayer. For such losses or bad debts must be ascertained to be so and written off during the taxable year, are therefore deductible in full or not at all, in the absence of any express provision in the Tax Code authorizing partial deductions.

The Tax Court held that the taxpayer's loss of its investment in its subsidiary could not be deducted for the year 1951, as the subsidiary was still in operation in 1951 and 1952. The taxpayer, on the other hand, claims that its advances were irretrievably lost because of the staggering losses suffered by its subsidiary in 1951 and that its advances after 1949 were "only limited to the purpose of salvaging whatever ore was already available, and for the purpose of paying the wages of the laborers who needed help."[7] The correctness of the Tax Court's ruling in sustaining the disallowance of the write-off in 1951 of the taxpayer's claimed losses is borne out by subsequent events shown in Cases L-24972 and L-24978 involving the taxpayer's 1957 income tax liability. (Infra, paragraph 6). It will there be seen that by 1956, the obligation of the taxpayer's subsidiary to it had been reduced from ₱587,398.97 in 1951 to ₱442,885.23 in 1956, and that it was only on January 1, 1956 that the subsidiary decided to cease operations.[8]

(c) *Disallowance of losses in Balamban Coal Mines (1950 and 1951)*— The Court sustains the Tax Court's disallowance of the sums of ₱8,989.76 and ₱27,732.66 spent by the taxpayer for the operation of its Balamban Coal Mines in Cebu in 1950 and 1951, respectively, and claimed as losses in the taxpayer's returns for said years. The Tax Court correctly held that the losses "are deductible in 1952, when the mines were abandoned, and not in 1950 and 1951, when they were still in operation."[9] The

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[7] Taxpayer's Brief as appellant, p. 22.

[8] CTA Decision in Case 787, Taxpayer's Brief, p. 74.

[9] *Idem*, pp. 66-67.

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taxpayer's claim that these expenditures should be allowed as losses for the corresponding years that they were incurred, because it made no sales of coal during said years, since the promised road or outlet through which the coal could be transported from the mines to the provincial road was not constructed, cannot be sustained. Some definite event must fix the time when the loss is sustained, and here it was the event of actual abandonment of the mines in 1952. The Tax Court held that the losses, totalling ₱36,722.42 were properly deductible in 1952, but the appealed judgment does not show that the taxpayer was credited therefor in the determination of its tax liability for said year. This additional deduction of ₱36,722.42 from the taxpayer's taxable income in 1952 would result in the elimination of the deficiency tax liability for said year in the sum of ₱3,600.00 as determined by the Tax Court in the appealed judgment.

(d) *and* (e) *Allowance of losses in Hacienda Dalupiri (1950 to 1954) and Hacienda Samal (1951-1952).*— The Tax Court overruled the Commissioner's disallowance of these items of losses thus:

"Petitioner deducted losses in the operation of its Hacienda Dalupiri the sums of ₱17,418.95 in 1950, ₱29,125.82 in 1951, ₱26,744.81 in 1952, ₱21,932.62 in 1953, and ₱42,938.56 in 1954. These deductions were disallowed by respondent on the ground that the farm was operated solely for pleasure or as a hobby and not for profit. This conclusion is based on the fact that the farm was operated continuously at a loss.

"From the evidence, we are convinced that the Hacienda Dalupiri was operated by petitioner for business and not pleasure. It was mainly a cattle farm, although a few race horses were also raised. It does not appear that the farm was used by petitioner for entertainment, social activities, or other non-business purposes. Therefore, it is entitled to deduct expenses and losses in connection with the operation of said farm. (See 1955 PH Fed. Taxes, Par. 13,663, citing G.C.M. 21103, CB 1939-1, p. 164)

Section 100 of Revenue Regulations No. 2, otherwise known as the Income Tax Regulations, authorizes farmers to determine their gross income on the basis of inventories. Said regulations provides:

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> 'If gross income is ascertained by inventories, no deduction can be made for livestock or products lost during the year, whether purchased for resale, produced on the farm, as such losses will be reflected in the inventory by reducing the amount of livestock or products on hand at the close of the year.'

"Evidently, petitioner determined its income or losses in the operation of said farm on the basis of inventories. We quoted from the memorandum of counsel for petitioner:

> 'The Taxpayer deducted from its income tax returns for the years from 1950 to 1954 inclusive, the corresponding yearly losses sustained in the operation of Hacienda Dalupiri, which losses represent the excess of its yearly expenditures over the receipts; that is, the losses represent the difference between the sales of livestock and the actual cash disbursements or expenses.' (Pages 21-22, Memorandum for Petitioner.)

"As the Hacienda Dalupiri was operated by petitioner for business and since it sustained losses in its operation, which losses were determined by means of inventories authorized under Section 100 of Revenue Regulations No. 2, it was error for respondent to have disallowed the deduction of said losses. The same is true with respect to losses sustanied in the operation of the Hacienda Samal for the years 1951 and 1952."[10]

The Commissioner questions that the losses sustained by the taxpayer were properly based on the inventory method of accounting. He concedes, however, "that the regulations referred to does not specify how the inventories are to be made. The Tax Court however, felt satisfied with the evidence presented by the taxpayer . . . which merely consisted of an alleged physical count of the number of the livestocks in Hacienda Dalupiri for the years involved."[11] The Tax Court was satisfied with the method adopted by the taxpayer as a farmer breeding livestock, reporting on the basis of receipts and disbursments. We find no compelling reason to disturb its findings.

2. *Disallowance of excessive depreciation of buildings.* (1950-1954).— During the years 1950 to 1954, the taxpayer

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[10] CTA decision in Case 787, Taxpayer's Brief as appellant, p. 68-70.

[11] Commissioner's Brief as appellant, p. 15-16.

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claimed a depreciation allowance for its buildings at the annual rate of 10%. The Commissioner claimed that the reasonable depreciation rate is only 3% per annum and hence disallowed as excessive the amount claimed as depreciation allowance in excess of 3% annually. We sustain the Tax Court's finding that the taxpayer did not submit adequate proof of the correctness of the taxpayer's claim that the depreciable assets or buildings in question had a useful life only of 10 years so as to justify its 10% depreciation per annum claim, such finding being supported by the record. The taxpayer's contention that it has many zero or one-peso assets,[12] representing very old and fully depreciated assets serves but to support the Commissioner's position that a 10% annual depreciation rate was excessive.

3. *Taxable increase in net worth (1950-1951).* — The Tax Court set aside the Commissioner's treatment as taxable income of certain increases in the taxpayer's net worth. It found that:

"For the year 1950, respondent determined that petitioner had an increase in net worth in the sum of ₱30,050.00, and for the year 1951, the sum of ₱1,382.85. These amounts were treated by respondent as taxable income of petitioner for said years.

"It appears that petitioner had an account with the Manila Insurance Company, the records bearing on which were lost. When its records were reconstituted the amount of ₱349,800.00 set up as its liability to the Manila Insurance Company. It was discovered later that the correct liability was only ₱319,750.00, or a difference of ₱30,050.00, so that the records were adjusted so as to show the correct liability. The correction or adjustment was made in 1950. Respondent contends that the reduction of petitioner's liability to Manila Insurance Company resulted in the increase of petitioner's net worth to the extent of ₱30,050.00 which is taxable. This is erroneous. The principle underlying the taxability of an increase in the net worth of a tax-payer rest on the theory that such an increase in net worth, if unreported and not explained by the taxpayer, comes from income derived from taxable source. (See Perez *v.* Araneta, G.R. No. L-9193, May 29, 1957; Coll. *vs.* Reyes, G.R. Nos. L-11534 & L-11558, Nov. 25, 1958.) In this case, the increase in the net worth of petitioner for 1950 to the extent of ₱30,050.00

[12] Taxpayer's Brief as appellant. p. 44.

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was not the result of the receipt by it of taxable income. It was merely the outcome of the correction of an error in the entry in its books relating to its indebtedness to the Manila Insurance Company. The Income Tax Law imposes a tax on income; it does not tax any or every increase in net worth whether or not derived from income. Surely, the said sum of ₱30,050 was not income to petitioner, and it was error for respondent to assess a deficiency income tax on said amount.

"The same holds true in the case of the alleged increase in net worth of petitioner for the year 1951 in the sum of ₱1,382.85. It appears that certain items (all amounting to ₱1,382.85) remained in petitioner's books as outstanding liabilities of trade creditors. These accounts were discovered in 1951 as having been paid in prior years, so that the necessary adjustments were made to correct the errors. If there was an increase in net worth of the petitioner, the increase in net worth was not the result of receipt by petitioner of taxable income."[13]

The Commissioner advances no valid grounds in his brief for contesting the Tax Court's findings. Certainly, these increases in the taxpayer's net worth were not taxable increases in net worth, as they were not the result of the receipt by it of unreported or unexplained taxable income, but were shown to be merely the result of the correction of errors in its entries in its books relating to its indebtednesses to certain creditors, which had been erroneously overstated or listed as outstanding when they had in fact been duly paid. The Tax Court's action must be affirmed.

4. *Gain realized from sale of real property (1950).*— We likewise sustain as being in accordance with the evidence the Tax Court's reversal of the Commissioner's assessment on an alleged unreported gain in the sum of ₱11,147.26 in the sale of a certain real property of the taxpayer in 1950. As found by the Tax Court, the evidence shows that this property was acquired in 1926 for ₱11,852.74, and was sold in 1950 for ₱60,000.00, apparently, resulting in a gain of ₱48,147.26.[14] The taxpayer reported in its return a gain of 37,000.00, or a discrepancy of ₱11,147.26.[15] It

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[13] CTA decision in Case 787, Taxpayer's Brief as appellant, pp. 70-72.

[14] Not ₱48,127.26, as erroneouly stated in the CTA decision.

[15] Not ₱11,852.74 as erroneously stated in the CTA decision.

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was sufficiently proved from the taxpayer's books that after acquiring the property, the taxpayer had made improvements totalling ₱11,147.26,[16] accounting for the apparent discrepancy in the reported gain. In other words, this figure added to the original acquisition cost of ₱11,852.74 results in a total cost of ₱23,000.00, and the gain derived from the sale of the property for ₱60,000.00 was correctly reported by the taxpayer at ₱37,000.00.

On the second issue of prescription, the taxpayer's contention that the Commissioner's action to recover its tax liability should be deemed to have prescribed for failure on the part of the Commissioner to file a complaint for collection against it in an appropriate civil action, as contradistinguished from the answer filed by the Commissioner to its petition for review of the questioned assessments in the case *a quo* has long been rejected by this Court. This Court has consistently held that "a judicial action for the collection of a tax is begun by the filing of a complaint with the proper court of first instance, or *where the assessment is appealed to the Court of Tax Appeals, by filing an answer to the taxpayer's petition for review wherein payment of the tax is prayed for.*"[17] This is but logical for where the taxpayer avails of the right to appeal the tax assessment to the Court of Tax Appeals, the said Court is vested with the authority to pronounce judgment as to the taxpayer's liability to the exclusion of any other court. In the present case, regardless of whether the assessments were made on February 24 and 27, 1956, as claimed by the Commissioner, or on December 27, 1955 as claimed by the taxpayer, the government's right to collect the taxes due has clearly not prescribed, as the taxpayer's appeal or petition for review was filed with the Tax Court on May 4, 1960, with the Commissioner filing on May 20, 1960 his Answer with a prayer

16 *Idem.* Apparently, the CTA inadvertently switched the figures.

17 Alhambra Cigar & Cigarette Mfg. Co. *vs.* Collector, 105 Phil. 1337, cited in Palanca *vs.* Commissioner, 4 SCRA 263, 266; Collector *vs.* Bohol Land Trans. Co., 107 Phil. 965, 972.

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for payment of the taxes due, long before the expiration of the five-year period to effect collection by judicial action counted from the date of assessment.

Cases L-24972 and L-24978

These cases refer to the taxpayer's income tax liability for the year 1957. Upon examination of its corresponding income tax return, the Commissioner assessed it for deficiency income tax in the amount of ₱38,918.76, computed as follows:

"Net income per return	₱29,178.70
Add: Unallowable deductions:	
(1) Net loss claimed on Ha. Dalupiri	89,547.33
(2) Amortization of Contractual right claimed as an expense under Mines Operations	48,481.62
Net income per investigation	₱167,297.65
Tax due thereon	38,818.00
Less: Amount already assessed	5,836.00
Balance	32,982.00
Add: 1/2% monthly interest from 6-20-59 to 6-20-62	5,936.76
TOTAL AMOUNT DUE AND COLLECTIBLE	₱38,918.76"[18]

The Tax Court overruled the Commissioner's disallowance of the taxpayer's losses in the operation of its Hacienda Dalupiri in the sum of ₱89,547.33 but sustained the disallowance of the sum of ₱48,481.62, which allegedly represented 1/5 of the cost of the "contractual right" over the mines of its subsidiary, Palawan Manganese Mines, Inc. which the taxpayer had acquired. It found the taxpayer liable for deficiency income tax for the year 1957 in the amount of ₱9,696.00, instead of ₱32,982.00 as originally assessed, and rendered the following judgment:

"WHEREFORE, the assessment appealed from is hereby modified. Petitioner is hereby ordered to pay to respondent the amount of ₱9,969.00 as deficiency income tax for the year 1957, plus the corresponding interest provided in Section 51 of the Revenue Code. If the deficiency tax is not paid in full within thirty (30) days from the date this decision becomes final and executory, petitioner shall pay a surcharge of five per cent (5%) of the

[18] CTA decision in CTA Case 1389, Annex C, Commissioner's Petition, p. 1.

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unpaid amount, plus interest at the rate of one per cent (1%) a month, computed from the date this decision becomes final until paid, provided that the maximum amount that may be collected as interest shall not exceed the amount corresponding to a period of three (3) years. Without pronouncement as to costs."[19]

Both parties again appealed from the respective adversed rulings against them in the Tax Court's decision.

5. *Allowance of losses in Hacienda Dalupiri (1957).*— The Tax Court cited its previous decision overruling the Commissioner's disallowance of losses suffered by the taxpayer in the operation of its Hacienda Dalupiri, since it was convinced that the hacienda was operated for business and not for pleasure. And in this appeal, the Commissioner cites his arguments in his appellant's brief in Case No. L-21557. The Tax Court, in setting aside the Commissioner's principal objections, which were directed to the accounting method used by the taxpayer found that:

"It is true that petitioner followed the cash basis method of reporting income and expenses in the operation of the Hacienda Dalupiri and used the accrual method with respect to its mine operations. This method of accounting, otherwise known as the hybrid method, followed by petitioner is not without justification.

'. . . A taxpayer may not, ordinarily, combine the cash and accrual bases. The 1954 Code provisions permit, however, the use of a hybrid method of accounting, combining a cash and accrual method, under circumstances and requirements to be set out in Regulations to be issued. Also, if a taxpayer is engaged in more than one trade or business he may use a different method of accounting for each trade or business. And a taxpayer may report income from a business on accrual basis and his personal income on the cash basis.' (See Mertens, Law of Federal Income Taxation, Zimet & Stanley Revision, Vol. 2, Sec. 12.08, p. 26.)"[20]

The Tax Court, having satisfied itself with the adequacy of the taxpayer's accounting method and procedure as properly reflecting

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[19] CTA decision in CTA Case 1389, Annex C, Commissioner's Petition, p. 6.

[20] CTA decision in CTA Case 1389, Annex C, Commissioner's Petition, p. 3.

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the taxpayer's income or losses, and the Commissioner having failed to show the contrary, we reiterate our ruling [*supra,* paragraph 1 (d) and (e)] that we find no compelling reason to disturb its findings.

6. *Disallowance of amortization of alleged "contractual rights."*— The reasons for sustaining this disallowance are thus given by the Tax Court:

"It appears that the Palawan Manganese Mines, Inc., during a special meeting of its Board of Directors on January 19, 1956, approved a resolution, the pertinent portions of which read as follows:

'RESOLVED, as it is hereby resolved, that the corporation's current assets composed of ores, fuel, and oil, materials and supplies, spare parts and canteen supplies appearing in the inventory and balance sheet of the Corporation as of December 31, 1955, with an aggregate value of ₱97,636.98, contractual rights for the operation of various mining claims in Palawan with a value of ₱100,000.00, its title on various mining claims in Palawan with a value of ₱142,408.10 or a total value of ₱340,045.08 be, as they hereby ceded and transferred to Fernandez Hermanos, Inc., as partial settlement of the indebtedness of the corporation to said Fernandez Hermanos, Inc., in the amount of ₱442,885.23.' (Exh. E, p. 17, CTA rec.)

"On March 29, 1956, petitioner's corporation accepted the above-offer of transfer, thus:

'WHEREAS, the Palawan Manganese Mines, Inc., due to its yearly substantial losses has decided to cease operation on January 1, 1956 and in order to satisfy at least a part of its indebtedness to the Corporation, it has proposed to transfer its current assets in the amount of NINETY SEVEN THOUSAND SIX HUNDRED THIRTY SIX PESOS & 98/100 (₱97,636.98) as per its balance sheet as of December 31, 1955, its contractual rights valued at ONE HUNDRED THOUSAND PESOS (₱100,000.00) and its title over various mining claims valued at ONE HUNDRED FORTY TWO THOUSAND FOUR HUNDRED EIGHT PESOS & 10/100 (₱142,408.10) or a total valuation of THREE HUNDRED FORTY THOUSAND FORTY FIVE PESOS & O8/100 (₱340.045.08) which shall be applied in partial settlement of its obligation to the Corporation in the amount of FOUR HUNDRED FORTY TWO THOUSAND EIGHT HUNDRED EIGHTY FIVE PESOS & 23/100 (₱442,885.23);' (Exh. E-1, p. 18, CTA rec.)

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"Petitioner determined the cost of the mines at ₱242,408.10 by adding the value of the contractual rights (₱100,000.00 and the value of its mining claims (₱142,408.10). Respondent disallowed the deduction on the following grounds: (1) that the Palawan Manganese Mines, Inc. could not transfer ₱242,408.10 worth of assets to petitioner because the balance sheet of the said corporation for 1955 shows that it had only current assets worth of ₱97,636.96; and (2) that the alleged amortization of 'contractual rights' is not allowed by the Revenue Code.

"The law in point is Section 30(g) (1) (B) of the Revenue Code, before its amendment by Republic Act No. 2698, which provided in part:

> '(g) ***Depletion of oil and gas wells and mines.***:
> '(1) ***In general.***—. . .
> (B) in the case of mines, a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof, which has been mined and sold during the year for which the return and computation are made. The allowances shall be made under rules and regulations to be prescribed by the Secretary of Finance: ***Provided,*** That when the allowances shall equal the capital invested, . . . no further allowance shall be made.'

"Assuming, ***arguendo,*** that the Palawan Manganese Mines, Inc. had assets worth ₱242,408.10 which it actually transferred to the petitioner in 1956, the latter cannot just deduct one-fifth (1/5) of said amount from its gross income for the year 1957 because such deduction in the form of depletion charge was not sanctioned by Section 30(g) (1) (B) of the Revenue Code, as above-quoted.

. . . .

"The sole basis of petitioner in claiming the amount of ₱48,481.62 as a deduction was the memorandum of its mining engineer (Exh. I, pp. 31-32, CTA rec.), who stated that the ore reserves of the Busuange Mines (Mines transferred by the Palawan Manganese Mines Inc. to the petitioner) would be exhausted in five (5) years, hence, the claim for ₱48,481.62 or one-fifth (1/5) of the alleged cost of the mines corresponding to the year 1957 and every year thereafter for a period of 5 years. The said memorandum merely showed the estimated ore reserves of the mines and its probable selling price. No evidence whatsoever was presented to show the produce mined and for how much they were sold during the year for which the return and computation were made. This is necessary in order to determine the amount of depletion that can be legally deducted from petitioner's gross income. The method employed by petitioner in making an outright deduction of 1/5

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of the cost of the mines is not authorized under Section 30(g) (1) (B) of the Revenue Code. Respondent's disallowance of the alleged 'contractual rights' amounting to ₱48,481.62 must therefore be sustained."[21]

The taxpayer insists in this appeal that it could use as a method for depletion under the pertinent provision of the Tax Code its "capital investment," representing the alleged value of its contractual rights and titles to mining claims in the sum of ₱242,408.10 and thus deduct outright one-fifth (1/5) of this "capital investment" every year, regardless of whether it had actually mined the product and sold the products. The very authorities cited in its brief give the correct concept of depletion charges that they "allow for the exhaustion of the capital value of the deposits by *production*;" thus, "as the cost of the raw materials must be deducted from the gross income before the net income can determined, so the estimated cost of the reserve used up is allowed." The alleged "capital investment" method invoked by the taxpayer is not a method of depletion, but the Tax Code provision, prior to its amendment by Section 1, of Republic Act No. 2698, which took effect on June 18, 1960, expressly provided that "when the allowances shall equal the capital invested . . . no further allowances shall be made;" in other words, the "capital investment" was but the limitation of the amount of depletion that could be claimed. The outright deduction by the taxpayer of 1/5 of the cost of the mines, as if it were a "straight line" rate of depreciation, was correctly held by the Tax Court not to be authorized by the Tax Code.

ACCORDINGLY, the judgment of the Court of Tax Appeals, subject of the appeals in Cases Nos. L-21551 and 21557, as modified by the crediting of the losses of ₱36,722.42 disallowed in 1950 and 1951 to the taxpayer for the year 1952 as directed in paragraph 1 (c) of this decision, is hereby affirmed. The judgment of the Court of Tax Appeals appealed from in Cases Nos. L-24972 and 24978 is affirmed *in toto*. No costs.

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21 CTA decision in CTA Case 1389, Annex C, Commissioner's Petition, pp. 4-5.

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SO ORDERED.

Concepcion, C.J., Dizon, Makalintal, Zaldivar, Sanchez, Ruiz Castro, Fernando, Capistrano and *Barredo, JJ.*, concur.

[G.R. No. L-22355. September 30, 1969]

ANTOLIN GALENO, petitioner-appellant, *vs.* REINERIO TICAO, in his capacity as Mayor of the City of Iloilo, respondent-appellee.

SYLLABUS

1. ADMINISTRATIVE LAW; REPUBLIC ACT 557; COMPLAINT AGAINST CITY POLICE OFFICER; FILING THEREOF BY ANY PERSON OR ENTITY; NOT MANDATORY FOR CITY MAYOR TO CHARGE POLICE OFFICER WITH CITY COUNCIL.— Under Section 1 of Republic Act 557, upon the mere filing by any person or entity with the city mayor of a complaint against a city police officer, it is not mandatory for the city mayor to prefer charges against the police officer with the city council.

2. ID.; ID.; PROCEDURE; SECTION 1 OF REPUBLIC ACT 557 REPEALED BY REP. ACT 4864, POLICE ACT OF 1966.— The procedure provided for in Section 1 of Republic Act 557 is not followed any more, because Republic Act 557 has been repealed by Republic Act 4864 known as the Police Act of 1966, which was enacted on September 8, 1966. The new procedure in the matter of preferring charges against police officers and the conduct of investigation of the charges are now provided in Sections 14 and 15 of said Police Act of 1966.

3. ID.; ID.; RULING OF THE COURT OF FIRST INSTANCE REGARDING PREFERMENT OF CHARGES AGAINST POLICE OFFICER; ACADEMIC WHEN REPUBLIC ACT 557 WAS REPEALED BY REPUBLIC ACT 4864.— The ruling embodied in the decision appealed from regarding the preferment of charges against a police officer may now be considered academic because of the repeal of Republic Act 557 by Republic Act 4864 known as the Police Act of 1966.