Supreme Court E-Library

SO ORDERED.

Zaldivar (Chairman), Fernando, Barredo, Antonio, and *Fernandez, JJ.*, concur.

FIRST DIVISION

[G.R. No. L-20569. August 23, 1974]

JOSE B. AZNAR, in his capacity as Administrator of the Estate of the deceased, Matias H. Aznar, *petitioner, vs.* **COURT OF TAX APPEALS and COLLECTOR OF INTERNAL REVENUE,** *respondents.*

SYLLABUS

1. **TAXATION; INCOME TAX; ASSESSMENTS; PRESCRIPTION; PROCEEDING FOR COLLECTION OF DEFICIENCY TAXES BASED ON FALSE RETURN, FRAUDULENT RETURN OR FAILURE TO FILE A RETURN PRESCRIBES IN TEN YEARS.**— In the three different cases of (1) false return, (2) fraudulent return with intent to evade tax, (3) failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the falsity, fraud, or omission.

2. **ID.; ID.; WORDS AND PHRASES; DISTINCTION BETWEEN FALSE RETURN AND FRAUDULENT RETURN EXPLAINED.**— Our stand that the law should be interpreted to mean a separation of the three different situations of false return, fraudulent return with intent to evade tax, and failure to file a return is strengthened immeasurably by the last portion of the provision which segregates the situations into three different classes, namely - "falsity," "fraud" and "omission." That there is a difference between "false return" and "fraudulent return" cannot be denied. While the first merely implies deviation from the truth, whether intentional or not, the second

Supreme Court E-Library

implies intentional or deceitful entry with intent to evade the taxes due.

3. **ID.; ID.; ASSESSMENTS; PRESCRIPTION; TEN YEARS PERIOD OF PRESCRIPTION APPLIES WHERE THE GOVERNMENT IS PREVENTED FROM MAKING PROPER ASSESSMENTS.**— The ordinary period of prescription of 5 years within which to assess tax liabilities under Sec. 331 of the NIRC should be applicable to normal circumstances, but whether the government is placed at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities due to false returns, fraudulent returns intended to evade payment of tax or failure to file returns, the period of ten years provided for in Sec. 332 (a) NIRC, from the time of the discovery of the falsity, fraud or omission even seems to be inadequate and should be the one enforced.

4. **ID.; COURT OF TAX APPEALS; FINDINGS OF FACT OF THE TAX COURT WILL NOT BE DISTURBED IF SUPPORTED BY SUBSTANTIAL EVIDENCE.**— As to the alleged errors committed by the Court of Tax Appeals in not deducting from the alleged undeclare income of the taxpayer for 1946 the proceeds from the sale of jewelries valued at P30,000; in not excluding from other schedules of assets of the taxpayer certain items, these issues would depend for their resolution on determination of questions of facts based on an evaluation of evidence, and the general rule is that the findings of fact of the Court of Tax Appeals supported by substantial evidence should not be disturbed upon review of its decision.

5. **ID.; INCOME TAX; ASSESSMENTS; RECONSTRUCTION OF PROPERTY DOES NOT RENDER IT VALUELESS AS AN ASSET.**— Regarding a house in Talisay, Cebu (covered by Tax Declaration No. 8165) which was listed as an asset during the years 1945 and 1947 to 1951, but which was not listed as an asset in 1946 because of a notation in the tax declaration that it was reconstructed in 1947, the lower court correctly concluded that the reconstruction of the property did not render it valueless during the time it was being reconstructed and consequently it should be listed as an asset as of January 1, 1946, with the same valuation as in 1945, that is P1,500.

Supreme Court E-Library

6. **ID.; ID.; ID.; TAXPAYER'S STATEMENTS TO THE BANK AS TO HIS ASSETS PREVAIL OVER CONTRARY CLAIMS MADE DURING THE HEARING.**— On the question of accounts receivables, doubtful accounts (bad debts), and valuation of buildings, it is clear that they were included in the taxpayer's statement given to the Philippine National Bank. These statements are to given greater credit over subsequent claims tending to alter the taxpayer's own estimate of his assets.

7. **ID.; ID.; ID.; BUILDINGS DESTROYED BY THE TYPHOON SHOULD BE WRITTEN OFF AS ASSETS OF THE TAXPAYER.**— Petitioner did not question the inclusion of these buildings in the inventory for the years prior to 1950, but objected to their inclusion as assets as of January 1, 1950, because both buildings were destroyed by a typhoon in November of 1949. There is sufficient evidence (Exh. G-1, etc.) to prove that the two buildings were really destroyed by typhoon in 1949 and therefore, should be eliminated from the petitioner's inventory of assets beginning December 31, 1949.

8. **ID.; ID.; ID.; EXPENSES IN HOLLOW-BLOCKS BUSINESS ARE INVESTMENT AND SHOULD BE TREATED AS ASSETS.** — The inclusion of expenses (labor and raw materials) as part of the hollow block business is sanctioned in the inventory method of tax verification. It is a sound accounting practice to include raw materials that will be used for future manufacture. Inclusion of direct labor is also proper, as all these items are to be embodied in a summary of assets. There is no evidence to show that there was duplication in the inclusion of the building used for hollow blocks business as part of petitioner's investment as this building was not included in the listing of real properties of petitioner (Exh. 45-C p. 187 B.I.R. rec.).

9. **ID.; ID.; PENALTIES; ACTUAL FRAUD, NOT CONSTRUCTIVE FRAUD, IS SUBJECT TO 50% SURCHARGE AS PENALTY.**— The lower court's conclusion regarding the existence of fraudulent intent to evade payment of taxes was based merely on a presumption and not on evidence establishing a willful filing of false and fraudulent returns so as to warrant the imposition of the fraud penalty. The fraud contemplated by law is actual and not constructive. It must be intentional fraud, consisting of deception willfully and deliberately done

Supreme Court E-Library

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.

APPEARANCES OF COUNSEL

Sato, Enad & Garcia for petitioner.

Solicitor General Arturo A. Alafriz, Solicitor Alejandro B. Afurong and Special Attorney Librada R. Natividad for respondents.

DECISION

ESGUERRA, *J.*:

Petitioner, as administrator of the estate of the deceased, Matias H. Aznar, seeks a review and nullification of the decision of the Court of Tax Appeals in C.T.A. Case No. 109, modifying the decision of respondent Commissioner of Internal Revenue and ordering the petitioner to pay the government the sum of P227,691.77 representing deficiency income taxes for the years 1946 to 1951, inclusive, with the condition that if the said amount is not paid within thirty days from the date the decision becomes final, there shall be added to the unpaid amount the surcharge of 5%, plus interest at the rate of 12% per annum from the date of delinquency to the date of payment, in accordance with Section 51 of the National Internal Revenue Code, plus costs against the petitioner.

It is established that the late Matias H. Aznar who died on May 18, 1958, predecessor in interest of herein petitioner, during his lifetime as a resident of Cebu City, filed his income tax returns on the cash and disbursement basis, reporting therein the following:

"Year	*Net Income*	*Amount of Tax Paid*	*Exhibit*
1945	P12,822.00	P114.66	pp. 85 - 88 B.I.R. rec.
1946	9,910.94	114.66	38-A (pp. 329-332 B.I.R. rec.)

Supreme Court E-Library

1947	10,200.00	132.00	39 (pp. 75-78 B.I.R. rec.)
1948	9,148.34		68.90 40 (pp. 70-73 B.I.R. rec.)
1949	8,990.66		59.72 41 (pp. 64-67 B.I.R. rec.)
1950	8,364.50		28.22 42 (pp. 59-62, BIR rec.)"
1951	6,800.00	none	43 (pp. 54-57 BIR rec.)"

The Commissioner of Internal Revenue having his doubts on the veracity of the reported income of one obviously wealthy, pursuant to the authority granted him by Section 38 of the National Internal Revenue Code, caused B.I.R. Examiner Honorio Guerrero to ascertain the taxpayer's true income for said years by using the net worth and expenditures method of tax investigation. The assets and liabilities of the taxpayer during the above-mentioned years were ascertained and it was discovered that from 1946 to 1951, his net worth had increased every year, which increases in net worth was very much more than the income reported during said years. The findings clearly indicated that the taxpayer did not declare correctly the income reported in his income tax returns for the aforesaid years.

Based on the above findings of Examiner Guerrero, respondent Commissioner, in his letter dated November 28, 1952, notified the taxpayer (Matias H. Aznar) of the assessed tax delinquency to the amount of P723,032.66, plus compromise penalty. The taxpayer requested a reinvestigation which was granted for the purpose of verifying the merits of the various objections of the taxpayer to the deficiency income tax assessment of November 28, 1952.

After the reinvestigation, another deficiency assessment to the reduced amount of P381,096.07 dated February 16, 1955, superseded the previous assessment and notice thereof was received by Matias H. Aznar on March 2, 1955.

The new deficiency assessment was based on the following computations:

1946

Net income per return	P	9,910.94
Add: Undeclared income		22,559.51
Net income per investigation	P	32,470.45

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Deduct: Personal and additional exemptions		6,917.00
Amount of income subject to tax	P	25,553.45
Total tax liability	P	3,801.76
Deduct: Income tax liability per return as assessed		114.66
Balance of tax due	P	3,687.10
Add: 50% surcharge		1,843.55
DEFICIENCY INCOME TAX		5,530.65

1947

Net income per return	P	10,200.00
Add: Underdeclared income		90,413.56
Net income per reinvestigation	P	100,613.56
Deduct: Personal and additional exemption		7,000.00
Amount of income subject to tax	P	93,613.56
Total tax liability	P	24,753.15
Deduct: Income tax liability per return as assessed		132.00
Balance of tax due	P	24,621.15
Add 50% surcharge		12,310.58
DEFICIENCY INCOME TAX	P	36,931.73

1948

Net income per return	P	9,148.34
Add Underdeclared income		15,624.63
Net income per reinvestigation	P	24,772.97
Deduct: Personal and additional exemptions		7,000.00
Amount of income subject to tax		17,772.97
Total tax liability		2,201.40
Deduct: Income tax liability per return as assessed		68.90
Balance of tax due	P	2,132.50
Add: 50% surcharge		1,066.25
DEFICIENCY INCOME TAX	P	3,198.75

Supreme Court E-Library

1949

Net income per return	P	9,990.66
Add: Underdeclared income		105,418.53
Net income per reinvestigation	P	114,409.19
Deduct: Personal and additional exemptions		P7,000.00
Amount of income subject to tax	P	107.409.19
Total tax liability	P	30,143.68
Deduct: Income tax liability per return as assessed		59.72
Balance of tax due	P	30,083.96
Add: 50% surcharge		15,041.98
DEFICIENCY INCOME TAX	P	45,125.94

1950

Net income per return	P	8,364.50
Add: Underdeclared income		365,578.76
Net income per reinvestigation	P	373,943.26
Deduct: Personal and additional exemptions		7,800.00
Amount of income subject to tax	P	366,143.26
Total tax liability	P	185,883.00
Deduct: Income tax liability per return as assessed		28.00
Balance of tax due	P	185,855.00
Add: 50% surcharge		92,928.00
DEFICIENCY INCOME TAX	P	278,783.00

1951

Net income per return	P	6,800.00
Add: Underdeclared income		33,355.80
Net income per reinvestigation	P	40,155.80
Deduct: Personal and additional exemptions		7,200.00
Amount of income subject to tax	P	32,955.80
Total tax liability		P7,684.00
Deduct: Income tax liability per return as assessed		- 0 -
Balance of tax due	P	7,684.00

Supreme Court E-Library

Add: 50% surcharge		3,842.00
DEFICIENCY INCOME TAX	P	11,526.00

SUMMARY

1946	P	5,530.65
1947		36,931.73
1948		3,198.75
1949		45,125.94
1950		278,783.00
1951		11,526.00
Total	P	381,096.07

In determining the unreported income, the respondent Commissioner of Internal Revenue resorted to the networth method which is based on the following computations:

1945

Real estate inventory	P	64,738.00
Other assets		37,606.87
Total assets	P	102,344.87
Less: Depreciation allowed		2,027.00
Networth as of Dec. 31, 1945	P	100,316.97

1946

Real estate inventory	P	86,944.18
Other assets		60,801.65
Total assets	P	147,745.83
Less: Depreciation allowed		4,875.41
Net assets	P	142,870.42
Less: Liabilities P 17,000.00		
Networth as of Jan. 1, 1946..100,316.97	P	117,316.97
Increase in networth		25,553.45
Add: Estimated living expenses		6,917.00
Net income	P	32,470.45

1947

Real estate inventory	P	237,824.18
Other assets		54,495.52
Total assets	P	292,319.70
Less: Depreciation allowed		12,835.72
Net assets	P	279,483.98

Supreme Court E-Library

Less: Liabilities	P60,000.00	
Networth as of Jan. 1, 1947	125,870.42	P 185,870.42
Increase in networth		P 93,613.56
Add: Estimated living expenses		7,000.00
Net income		P 100,613.56

1948

Real estate inventory		P 244,824.18
Other assets		118,720.60
Total assets		P 363,544.78
Less: Depreciation allowed		20,936.03
Net assets		P 342,608.75
Less: Liabilities	P105,351.80	
Networth as of Jan. 1, 1948	219,483.98 ..	P 324,835.78
Increase in networth		P 17,772.97
Add: Estimated living expenses		7,000.00
Net income		P 24,772.97

1949

Real estate inventory		P 400,515.52
Investment in schools and other colleges		23,105.29
Other assets		70,311.00
Total assets		P 493.931.81
Less: Depreciation allowed		32,657.08
Net assets		P 461,274.73
Less: Liabilities	P116,608.59	
Networth as of Jan. 1, 1949	237,256.95 ...	P 353,865.54
Increase in networth		P 107,409.19
Add: Estimated living expenses		7,000.00
Net income		P 114,409.19

1950

Real estate inventory		P 412,465.52
Investment in Schools and other colleges		193,460.99
Other assets		310,788.87

Supreme Court E-Library

Total assets		P 916,715.38
Less: Depreciation allowed		47,561.99
Net assets		P 869,153.39
Less Liabilities	P158,343.99	
Networth as of Jan. 1, 1950	344,666.14	P 503,010.13
Increase in networth		P 366,143.26
Add: Estimated living expenses		7,800.00
Net income		P 373,943.26

1951

Real estate inventory		P 412,465.52
Investment in schools and other colleges		214,016.21
Other assets		320,209.40
Total assets		P 946,691.13
Less: Depreciation allowed		62,466.90
Net assets		P 884,224.23
Less: Liabilities	P140,459.03	
Networth as of Jan. 1, 1951	710,809.40	P 851,268.43
Increase in networth		P 32,955.80
Add: Estimated living expenses		7,200.00
Net income		P 40,155.80

(Exh. 45-B, BIR rec. p. 188).

On February 20, 1953, respondent Commissioner of Internal Revenue, thru the City Treasurer of Cebu, placed the properties of Matias H. Aznar under distraint and levy to secure payment of the deficiency income tax in question. Matias H. Aznar filed his petition for review of the case with the Court of Tax Appeals on April 1, 1955, with a subsequent petition immediately thereafter to restrain respondent from collecting the deficiency tax by summary method, the latter petition being granted on February 8, 1956, per C.T.A. resolution, without requiring petitioner to file a bond. Upon review, this Court set aside the C.T.A. resolution and required the petitioner to deposit with the Court of Tax Appeals the amount demanded by the Commissioner of Internal Revenue for the years 1949 to 1951 or furnish a surety bond for not more than double the amount.

Supreme Court E-Library

On March 5, 1962, in a decision signed by the presiding judge and the two associate judges of the Court of Tax Appeals, the lower court concluded that the tax liability of the late Matias H. Aznar for the year 1946 to 1951, inclusive should be P227,788.64 minus P96.87 representing the tax credit for 1945, or P227,691.77, computed as follows:

1946

Net income per return	P	9,910.94
Add: Underdeclared income		22,559.51
Net income	P	32,470.45
Less: Personal and additional exemptions		6,917.00
Income subject to tax	P	25,553.45
Tax due thereon	P	3,801.76
Less: Tax already assessed		114.66
Balance of tax due	P	3,687.10
Add: 50% surcharge		1,843.55
Deficiency income tax	P	5,530.65

1947

Net income per return	P	10,200.00
Add: Underdeclared income		57,551.19
Net income	P	67,751.19
Less: Personal and additional exemptions		7,000.00
Income subject to tax	P	60,751.19
Tax due thereon	P	13,420.38
Less: Tax already assessed		132.00
Balance of tax due	P	13,288.38
Add: 50% surcharge		6,644.19
Deficiency income tax	P	19,932.57

1948

Net income per return	P	9,148.34
Add: Underdeclared income		8,732.10
Net income	P	17,880.44
Less: Personal and additional exemptions		7,000.00

Supreme Court E-Library

Income subject to tax	P	10,880.44
Tax due thereon	P	1,029.67
Less: Tax already assessed		68.90
Balance of tax due	P	960.77
Add: 50% surcharge		480.38
Deficiency income tax	P	1,441.15

1949

Net income per return	P	8,990.66
Add: Underdeclared income		43,718.53
Net income	P	52,709.19
Less: Personal and additional exemptions		7,000.00
Income subject to tax	P	45,709.19
Tax due thereon	P	8,978.57
Less: Tax already assessed		59.72
Balance of tax due	P	8,918.85
Add: 50% surcharge		4,459.42
Deficiency income tax	P	13,378.27

1950

Net income per return	P	8,364.50
Add: Underdeclared income		246,449.06
Net income	P	254,813.56
Less: Personal and additional exemptions		7,800.00
Income subject to tax	P	247,013.56
Tax due thereon	P	117,348.00
Less: Tax already assessed		28.00
Balance of tax due	P	117,320.00
Add: 50% surcharge		58,660.00
Deficiency Income tax	P	175,980.00

1951

Net income per return	P	6,800.00
Add: Underdeclared income		33,355.80
Net income	P	40,155.80
Less: Personal and additional exemptions		7,200.00
Income subject to tax	P	32,955.80

Supreme Court E-Library

Tax due thereon	P	7,684.00
Less: Tax already assessed		- o -
Balance of tax due	P	7,684.00
Add: 50% surcharge		3,842.00
Deficiency income tax	P	11,526.00

SUMMARY

1946	P	5,530.65
1947		19,932.57
1948		1,441.15
1949		13,378.27
1950		175,980.00
1951		11,526.00
	P	227,788.64

I

The first vital issue to be decided here is whether or not the right of the Commissioner of Internal Revenue to assess deficiency income taxes of the late Matias H. Aznar for the years 1946, 1947, and 1948 had already prescribed at the time the assessment was made on November 28, 1952.

Petitioner's contention is that the provision of law applicable to this case is the period of five years limitation upon assessment and collection from the filing of the returns provided for in Sec. 331 of the National Internal Revenue Code. He argues that since the 1946 income tax return could be presumed filed before March 1, 1947 and the notice of final and last assessment was received by the taxpayer on March 2, 1955, a period of about 8 years had elapsed and the five year period provided by law (Sec. 331 of the National Internal Revenue Code) had already expired. The same argument is advanced on the taxpayer's return for 1947, which was filed on March 1, 1948, and the return for 1948, which was filed on February 28, 1949. Respondents, on the other hand, are of the firm belief that regarding the prescriptive period for assessment of tax returns, Section 332 of the National Internal Revenue Code should apply because, as in this case, "(a) In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return, the tax may be assessed, or a proceeding in court for the collection

Supreme Court E-Library

such tax may be begun without assessment, at any time within ten years after the discovery of the falsity, fraud or omission" (Sec. 332 [a] of the NIRC).

Petitioner argues that Sec. 332 of the NIRC does not apply because the taxpayer did not file false and fraudulent returns with intent to evade tax, while respondent Commissioner of Internal Revenue insists contrariwise, with respondent Court of Tax Appeals concluding that the very "substantial underdeclarations of income for six consecutive years eloquently demonstrate the falsity or fraudulence of the income tax returns with an intent to evade the payment of tax."

To our minds we can dispense with these controversial arguments on facts, although we do not deny that the findings of facts by the Court of Tax Appeals, supported as they are by very substantial evidence, carry great weight, by resorting to a proper interpretation of Section 332 of the NIRC. We believe that the proper and reasonable interpretation of said provision should be that in the three different cases of (1) false return, (2) fraudulent return with intent to evade tax, (3) failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the (1) falsity, (2) fraud, (3) omission. Our stand that the law should be interpreted to mean a separation of the three different situations of false return, fraudulent return with intent to evade tax, and failure to file a return is strengthened immeasurably by the last portion of the provision which segregates the situations into three different classes, namely "falsity," "fraud" and "omission." That there is a difference between "false return" and "fraudulent return" cannot be denied. While the first merely implies deviation from the truth, whether intentional or not, the second implies intentional or deceitful entry with intent to evade the taxes due.

The ordinary period of prescription of 5 years within which to assess tax liabilities under Sec. 331 of the NIRC should be applicable to normal circumstances, but whenever the government is placed at a disadvantage so as to prevent its

Supreme Court E-Library

lawful agents from proper assessment of tax liabilities due to false returns, fraudulent return intended to evade payment of tax or failure to file returns, the period of ten years provided for in Sec. 332 (a) NIRC, from the time of the discovery of the falsity, fraud or omission even seems to be inadequate and should be the one enforced.

There being undoubtedly false tax returns in this case, We affirm the conclusion of the respondent Court of Tax Appeals that Sec. 332 (a) of the NIRC should apply and that the period of ten years within which to assess petitioner's tax liability had not expired at the time said assessment was made.

II

As to the alleged errors committed by the Court of Tax Appeals in not deducting from the alleged undeclared income of the taxpayer for 1946 the proceeds from the sale of jewelries valued at P30,000; in not excluding from other schedules of assets of the taxpayer (a) accounts receivable from customers in the amount of P38,000 for 1948, P126,816.50 for 1950, and provisions for doubtful accounts in the amount of P41,810.56 for 1950; (b) over valuation of hospital and dental buildings for 1949 in the amount of P32,000 and P6,191.32 respectively; (c) investment in hollow block business in the amount of P8,603.22 for 1949; (d) over valuation of surplus goods in the amount of P23,000 for the year 1949; (e) various lands and buildings included in the schedule of assets for the years 1950 and 1951 in the total amount of P243,717.42 for 1950 and P62,564.00 for 1951, these issues would depend for their resolution on determination of questions of facts based on an evaluation of evidence, and the general rule is that the findings of fact of the Court of Tax Appeals supported by substantial evidence should not be disturbed upon review of its decision (Section 2, Rule 44, Rules of Court).

On the question of the alleged sale of P30,000 worth of jewelries in 1946, which amount petitioner contends should be deducted from the taxpayer's net worth as of December 31, 1946, the record shows that Matias H. Aznar, when interviewed by B.I.R. Examiner Guerrero, stated that at the beginning of

Supreme Court E-Library

1945 he had P60,000 worth of jewelries inherited from his ancestors and were disposed off as follows: 1945, P10,000; 1946, P20,000; 1947, P10,000; 1948, P10,000; 1949, P7,000; (Report of B.I.R. Examiner Guerrero, B.I.R. rec. pp. 90-94).

During the hearing of this case in the Court of Tax Appeals, petitioner's accountant testified that on January 1, 1945, Matias H. Aznar had jewelries worth P60,000 which were acquired by purchase during the Japanese occupation (World War II) and sold on various occasions, as follows: 1945, P5,000 and 1946, P30,000. To corroborate the testimony of the accountant, Mrs. Ramona Agustines testified that she bought from the wife of Matias H. Aznar in 1946 a diamond ring and a pair of earrings for P30,000; and in 1947 a wrist watch with diamonds, together with antique jewelries, for P15,000. Matias H. Aznar, on the other hand testified that in 1945, his wife sold to Sards Parino jewelries for P5,000 and others to Mrs. Ramona Agustines for about P35,000. In answer to another question, Mr. Aznar stated that his transaction with Sards Parino, with respect to the sale of jewelries, amounted to P15,000.

The lower court did not err in finding material inconsistencies in the testimonies of Matias H. Aznar and his witnesses with respect to the values of the jewelries allegedly disposed off as stated by the witnesses. Thus, Mr. Aznar stated to the B.I.R. examiner that jewelries worth P10,000 were sold in 1945, while his own accountant testified that the same jewelries were sold for only P5,000. Mr. Aznar also testified that Mrs. Agustines purchased from his wife jewelries for P35,000, and yet Mrs. Agustines herself testified that she bought jewelries for P30,000 and P15,000 on two occasions, or a total of P45,000.

We do not see any plausible reason to challenge the fundamentally sound basis advanced by the Court of Tax Appeals in considering the inconsistencies of the witnesses' testimony as material, in the following words:

"We do not say that witnesses testifying on the same transaction should give identical testimonies. Because of the frailties and the limitations of the human mind, witnesses' statements are apt to be inconsistent in certain points, but usually the inconsistencies refer

Supreme Court E-Library

to the minor phases of the transaction. It is the insignificance of the detail of an occurrence that fails to impress the human mind. When that same mind is made to recall what actually happened, the insignificant point which it failed to take note is naturally left out. But, it is otherwise as regards significant matters, for they leave indelible imprints upon the human mind. Hence, testimonial inconsistencies on the minor details of an occurrence are dismissed lightly by the courts, while discrepancies on significant points are taken seriously and weigh adversely to the party affected thereby."

There is no sound basis for deviating from the lower court's conclusion that: "Taxwise, in view of the aforesaid inconsistencies, which we deem material and significant, we dismiss as without factual basis petitioner's allegation that jewelries form part of his inventory of assets for the purpose of establishing his net worth at the beginning of 1946."

As to the accounts receivable from the United States government for the amount of P38,254.90, representing a claim for goods commandered by the U.S. Army during World War II, and which amount petitioner claimed should be included in his net worth as of January 1, 1946, the Court of Tax Appeals correctly concluded that the uncontradicted evidence showed that "the collectible accounts of Mr. Aznar from the U.S. Government in the sum of P38,254.90 should be added to his assets (under accounts receivable) as of January 1, 1946. As of December 31, 1947, and December 31, 1948, the years within which the accounts were paid to him, the 'accounts receivable' shall decrease by P31,362.37 and P6,892.53, respectively."

Regarding a house in Talisay, Cebu (covered by Tax Declaration No. 8165) which was listed as an asset during the years 1945 and 1947 to 1951, but which was not listed as an asset in 1946 because of a notation in the tax declaration that it was reconstructed in 1947, the lower court correctly concluded that the reconstruction of the property did not render it valueless during the time it was being reconstructed and consequently it should be listed as an asset as of January 1, 1946, with the same valuation as in 1945, that is P1,500.

On the question of accounts receivable from customers in the amount of P38,000 for 1948, and P123,816.58 for the years

Supreme Court E-Library

1950 and 1951, which were included in the assets of Mr. Aznar for those years by the respondent Commissioner of Internal Revenue, it is very clear that those figures were taken from the statements (Exhs. 31 and 32) filed by Mr. Matias H. Aznar with the Philippine National Bank when he was intending to obtain a loan. These statements were under oath and the natural implication is that the information therein reflected must be the true and accurate financial condition of the one who executed those statements. To believe the petitioner's argument that the late Mr. Aznar included those figures in his sworn statement only for the purpose of obtaining a bigger credit from the bank is to cast suspicion on the character of a man who can no longer defend himself. It would be as if pointing the finger of accusation on the late Mr. Aznar that he intentionally falsified his sworn statements (Exhs. 31 and 32) to make it appear that there were non-existent accounts receivable just to increase his assets by fictitious entries so that his credit with the Philippine National Bank could be enhanced. Besides, We do not lose sight of the fact that those statements (Exhs. 31 and 32) were executed before this tax controversy arose and the disputable presumptions that a person is innocent of crime or wrong; that a person intends the ordinary consequences of his voluntary act; that a person takes ordinary care of his concerns; that private transaction have been fair and regular; that the ordinary course of business has been followed; that things have happened according to the ordinary course of nature and the ordinary habits of life; that the law has been obeyed [Sec. 5, (a), (c), (d), (p), (q), (z), (ff), Rule 131 of the Rules of Court], together with the conclusive presumption that "whenever a party has, by his own declaration, act, or omission, intentionally and deliberately led another to believe a particular thing true, and to act upon such belief, he cannot, in any litigation arising out of such declaration, act or omission, be permitted to falsify it" [Sec. 3 (a), Rule 131, Rules of Court], convincingly indicate that the accounts receivable stated by Mr. Aznar in Exhibits 31 and 32 were true, in existence, and accurate to the very amounts mentioned.

There is no merit to petitioners argument that those statements were only for the purpose of obtaining a bigger credit from

Supreme Court E-Library

the bank (impliedly stating that those statements were false) and those accounts were allegedly back accounts of students of the Southwestern Colleges and were worthless, and if collected, would go to the funds of the school. The statement of the late Mr. Aznar that they were accounts receivable from customers should prevail over the mere allegation of petitioner, unsupported as they are by convincing evidence. There is no reason to disturb the lower court's conclusion that the amounts of P38,000 and P123,816.58 were accounts receivable from customers and as such must be included as petitioner's assets for the years indicated.

As to the questions of doubtful accounts (bad debts), for the amount of P41,810.56, it is clear that said amount is taken from Exhibit 31, the sworn statement of financial condition filed by Mr. Matias H. Aznar with the Philippine National Bank. The lower court did not commit any error in again giving much weight to the statement of Mr. Aznar and in concluding that inasmuch as this is an item separate and apart from the taxpayer's accounts receivable and a non-deductible expense, it should be reverted to the accounts receivable and, consequently, considered as an asset in 1950.

On the alleged over valuation of two buildings (hospital building which respondent Commissioner of Internal Revenue listed as an asset from 1949-1951 at the basic valuation of P130,000, and which petitioner claims to be over valued by P32,000; dentistry building valued by respondent Commissioner of Internal Revenue at P36,191.34, which petitioner claims to be over valued by P6,191.34), We find no sufficient reason to alter the conclusion of respondent Court of Tax Appeals sustaining the respondent Commissioner of Internal Revenue's valuation of both properties.

Respondent Commissioner of Internal Revenue based his valuation of the hospital building on the representation of Mr. Matias H. Aznar himself who, in his letter (Exh. 35) to the Philippine National Bank dated September 5, 1949, stated that the hospital building cost him P132,000. However in view of the effect of a typhoon in 1949 upon the building, the value

Supreme Court E-Library

allowed was P130,000. Exhibit 35, contrary to petitioner's contention, should be given probative value because, although it is an unsigned plain copy, that exhibit was taken by the investigating examiner of the B.I.R. from the files of the Southwestern Colleges and formed part of his report of investigation as a public official. The estimates of an architect and a civil engineer who agreed that a value of P84,240 is fair for the hospital building, made years after the building was constructed, cannot prevail over the petitioner's own estimate of his property's value.

Respondent Commissioner of Internal Revenue's valuation of P36,191.34 of the Dentistry Building is based on the letter of Mr. and Mrs. Matias H. Aznar to the Southwestern Colleges, dated December 15, 1950, which is embodied in the minutes of the meeting of the Board of Trustees of the Southwestern Colleges held on May 7, 1951 (Exhibit G-1). In Exhibit 26 A, which is the cash book of the Southwestern Colleges, this building was listed as of the same amount. Petitioner's estimate of P30,000 for this building, based on Architect Paca's opinion, cannot stand against the owner's estimate and that which appears in the cash book of the Southwestern Colleges, if we take into consideration that the owner's (Mr. Matias H. Aznar) letter was written long before this tax proceeding was initiated, while architect Paca's estimate was made upon petitioner's request solely for the purpose of evidence in this tax case.

In the inventory of assets of petitioner, respondent Commissioner of Internal Revenue included the administrative building valued at P19,200 for the years 1947 and 1948, and P16,700 for the years 1949 to 1951; and a high school building valued at P48,000 for 1947 and 1948, and P45,000 for 1949, 1950 and 1951. The reduced valuation for the latter years are due to allowance for partial loss resulting from the 1949 typhoon. Petitioner did not question the inclusion of these buildings in the inventory for the years prior to 1950, but objected to their inclusion as assets as of January 1, 1950, because both buildings were destroyed by a typhoon in November of 1949. There is sufficient evidence (Exh. G-1, affidavit of Jesus S. Intan, employee in the office of City Assessor of Cebu City, Exh.

Supreme Court E-Library

18, Mr. Intan's testimony, a copy of a letter of the City Assessor of Cebu City) to prove that the two buildings were really destroyed by typhoon in 1949 and, therefore, should be eliminated from the petitioner's inventory of assets beginning December 31, 1949.

On the issue of investment in the hollow blocks business, We see no compelling reason to alter the lower court's conclusion that "whatever was spent in the hollow blocks business is an investment, and being an investment, the same should be treated as an asset. With respect to the amount representing the value of the building, there is no duplication in the listing as the inventory of real property does not include the building in question."

Respondent Commissioner of Internal Revenue included in the inventory, under the heading of other asset, the amount of P8,663.22, treated as investment in the hollow block business. Petitioner objects to the inclusion of P1,683.42 which was spent on the building and in the business and of P674.35 which was spent for labor, fuel, raw materials, office supplies etc., contending that the former amount is a duplication of inventory (included among the list of properties) and the latter is a business expense which should be eliminated from the list of assets.

The inclusion of expenses (labor and raw materials) as part of the hollow block business is sanctioned in the inventory method of tax verification. It is a sound accounting practice to include raw materials that will be used for future manufacture. Inclusion of direct labor is also proper, as all these items are to be embodied in a summary of assets (investment by the taxpayer credited to his capital account as reflected in Exhibit 72-A, which is a working sheet with entries taken from the journal of the petitioner concerning his hollow blocks business), There is no evidence to show that there was duplication in the inclusion of the building used for hollow blocks business as part of petitioner's investment as this building was not included in the listing of real properties of petitioner (Exh, 45-C p, 187 B.I.R. rec.).

Supreme Court E-Library

As to the question of the real value of the surplus goods purchased by Mr. Matias H. Aznar from the U.S. Army, the best evidence, as observed correctly by the lower court, is the statement of Mr. Matias H. Aznar, himself, as appearing in Exh. 35 (copy of a letter dated September 5, 1949 to the Philippine National Bank), to the effect "as part of my assets I have different merchandise from Warehouse 35, Tacloban, Leyte at a total cost of P43,000.00 and valued at no less than P20,000 at present market value." Petitioner's claim that the goods should be valued at only P20,000 in accordance with an alleged invoice is not supported by evidence since the invoice was not presented as exhibit. The lower court's act in giving more credence to the statement of Mr. Aznar cannot be questioned in the light of clear indications that it was never controverted and it was given at a time long before the tax controversy arose.

The last issue on propriety of inclusion in petitioner's assets as made by respondent Commissioner of Internal Revenue concerns several buildings which were included in the list of petitioner's assets as of December 31, 1950, Petitioner contends that those buildings were conveyed and ceded to the Southwestern Colleges on December 15, 1950, in consideration of P100,723,99 to be paid in cash. The value of the different buildings are listed as: hospital building, P130,000; gymnasium, P43,000; dentistry building, P36,191,34; bodega 1, P781.18; bodega 2, P7,250; college of law, P10,950; laboratory building, P8,164; home economics, P5,621; morgue, P2,400; science building, P23,600; faculty house, P5,760. It is suggested that the value of the buildings be eliminated from the real estate inventory and the sum of P100,723.99 be included as asset as of December 31, 1950.

The lower court could not find any evidence of said alleged transfer of ownership from the taxpayer to the Southwestern Colleges as of December 15, 1950, an allegation which if true could easily be proven. What is evident is that those buildings were used by the Southwestern Colleges. It is true that Exhibit G-1 shows that Mr. and Mrs. Matias H. Aznar offered those properties in exchange for shares of stocks of the Southwestern

Supreme Court E-Library

Colleges, and Exhibit "G" which is the minutes of the meeting of the Board of Trustees of the Southwestern Colleges held on August 6, 1951, shows that Mr. Aznar was amenable to the value fixed by the board of trustees and that he requested to be paid in cash instead of shares of stock. But those are not sufficient evidence to prove that transfer of ownership actually happened on December 15, 1950. Hence, the lower court did not commit any error in sustaining the respondent Commissioner of Internal Revenue's act of including those buildings as part of the assets of petitioner as of December 31, 1950.

Petitioner also contends that properties allegedly ceded to the Southwestern Colleges in 1951 for P150,000 worth of shares of stocks, consisting of: land, P22,684; house, P13,700; group of houses, P8,000; building, P12,000; nurses home, P4,100; nurses home, P2,080, should be excluded from the inventory of assets as of December 31, 1951. The evidence (Exh. H), however, clearly shows that said properties were formally conveyed to the Southwestern Colleges only on September 25, 1952. Undoubtedly, petitioner was the owner of those properties prior to September 25, 1952 and said properties should form part of his assets as of December 31, 1951.

The uncontested portions of the lower court's decision consisting of its conclusions that library books valued at P7,041.03, appearing in a journal of the Southwestern Colleges marked as Exhibit 25-A, being an investment, should be treated as an asset beginning December 31, 1950; that the expenses for construction to the amount of P113,353.70, which were spent for the improvement of the buildings appearing in Exhibit 24 are deemed absorbed in the increased value of the buildings as appraised by respondent Commissioner of Internal Revenue at cost after improvements were made, and should be taken out as additional assets; that the amount receivable of P5,776 from a certain Benito Chan should be treated as petitioner's asset but the amount of P5,776 representing the value of a house and lot given as collateral to secure said loan should not be considered as an asset of petitioner since to do so would result in a glaring duplication of items, are all affirmed. There

Supreme Court E-Library

seems to be no controversy as to the rest of the items listed in the inventory of assets.

III

The second issue which appears to be of vital importance in this case centers on the lower court's imposition of the fraud penalty (surcharge of 50% authorized in Section 72 of the Tax Code). The petitioner insists that there might have been false returns by mistake filed by Mr. Matias H. Aznar as those returns were prepared by his accountant employees, but there were no proven fraudulent returns with intent to evade taxes that would justify the imposition of the 50% surcharge authorized by law as fraud penalty.

The lower court based its conclusion that the 50% fraud penalty must be imposed on the following reasoning:

"It appears that Matias H. Aznar declared net income of P9,910.94, P10,200, P9,148.34, P8,990.66, P8,364.50 and P6,800 for the years 1946, 1947, 1948, 1949, 1950 and 1951, respectively. Using the net worth method of determining the net income of a taxpayer, we find that he had net incomes of P32,470.45, P67,751.19, P17,880.44, P52,709.11, P254,813.56 and P40,155.80 during the respective years 1946, 1947, 1948, 1949, 1950, and 1951. In consequence, he underdeclared his income by 227% for 1946, 564% for 1947, 95% for 1948, 486% for 1949, 2,946% for 1950 and 490% for 1951. These substantial underdeclarations of income for six consecutive years eloquently demonstrate the *falsity or fraudulence of the income tax returns with an intent to evade* the payment of tax. Hence the imposition of the fraud penalty is proper (Perez *vs.* Court of Tax Appeals, G.R. No. L-10507, May 30, 1958)." (Italics ours)

As could be readily seen from the above rationalization of the lower court, no distinction has been made between false returns (due to mistake, carelessness or ignorance) and fraudulent returns (with intent to evade taxes). The lower court based its conclusion on the petitioner's alleged fraudulent intent to evade taxes on the substantial difference between the amounts of net income on the face of the returns as filed by him in the years 1946 to 1951 and the net income as determined by the inventory method utilized by both respondents for the same years. The

Supreme Court E-Library

lower court based its conclusion on a presumption that fraud can be deduced from the very substantial disparity of incomes as reported and determined by the inventory method and on the similarity of consecutive disparities for six years. Such a basis for determining the existence of fraud (intent to evade payment of tax) suffers from an inherent flaw when applied to this case. It is very apparent here that the respondent Commissioner of Internal Revenue, when the inventory method was resorted to in the first assessment, concluded that the correct tax liability of Mr. Aznar amounted to P723,032.66 (Exh. 1, B.I.R. rec. pp. 126-129). After a reinvestigation the same respondent, in another assessment dated February 16, 1955, concluded that the tax liability should be reduced to P381,096.07. This is a crystal-clear, indication that even the respondent Commissioner of Internal Revenue with the use of the inventory method can commit a glaring mistake in the assessment of petitioner's tax liability. When the respondent Court of Tax Appeals reviewed this case on appeal, it concluded that petitioner's tax liability should be only P227,788.64. The lower court in three instances (elimination of two buildings in the list of petitioner's assets beginning December 31, 1949, because they were destroyed by fire; elimination of expenses for construction in petitioner's assets as duplication of increased value in buildings, and elimination of value of house and lot in petitioner's assets because said property was only given as collateral) supported petitioner's stand on the wrong inclusions in his lists of assets made by the respondent Commissioner of Internal Revenue, resulting in the very substantial reduction of petitioner's tax liability by the lower court. The foregoing shows that it was not only Mr. Matias H. Aznar who committed mistakes in his report of his income but also the respondent Commissioner of Internal Revenue who committed mistakes in his use of the inventory method to determine the petitioner's tax liability. The mistakes committed by the Commissioner of Internal Revenue which also involve very substantial amounts were also repeated yearly, and yet we cannot presume therefrom the existence of any taint of official fraud.

From the above exposition of facts, we cannot but emphatically reiterate the well established doctrine that fraud cannot

Supreme Court E-Library

be presumed but must be proven. As a corollary thereto, we can also state that fraudulent intent could not be deduced from mistakes however frequent they may be, especially if such mistakes emanate from erroneous entries or erroneous classification of items in accounting methods utilized for determination of tax liabilities. The predecessor of the petitioner undoubtedly filed his income tax returns for the years 1946 to 1951 and those tax returns were prepared for him by his accountant and employees. It also appears that petitioner in his lifetime and during the investigation of his tax liabilities cooperated readily with the B.I.R. and there is no indication in the record of any act of bad faith committed by him.

The lower court's conclusion regarding the existence of fraudulent intent to evade payment of taxes was based merely on a presumption and not on evidence establishing a willful filing of false and fraudulent returns so as to warrant the imposition of the fraud penalty. 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 the 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.

We conclude that the 50% surcharge as fraud penalty authorized under Section 72 of the Tax Code should not be imposed, but eliminated from the income tax deficiency for each year from 1946 to 1951, inclusive. The tax liability of the petitioner for each year should, therefore, be:

Supreme Court E-Library

1946	P 3,687.10
1947	13,288.38
1948	960.77
1949	8,918.85
1950	117,320.00
1951	7,684.00
	P 151,859.10

The total sum of P151,859.10 should be decreased by P96.87 representing the tax credit for 1945, thereby leaving a balance of P151,762.23.

WHEREFORE, the decision of the Court of Tax Appeals is modified in so far as the imposition of the 50% fraud penalty is concerned, and affirmed in all other respects. The petitioner is ordered to pay to the Commissioner of Internal Revenue, or his duly authorized representative, the sum of P151,762.23, representing deficiency income taxes for the years 1946 to 1951, inclusive, within 30 days from the date this decision becomes final. If the said amount is not paid within said period, there shall be added to the unpaid amount the surcharge of 5%, plus interest at the rate of 12% per annum from the date of delinquency to the date of payment, in accordance with Section 51 of the National Internal Revenue Code.

With costs against the petitioner.

Makalintal, C.J., Ruiz Castro, Makasiar, and *Muñoz Palma, JJ.*, concur.

Teehankee, J., concurs in the result.