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WHEREFORE, the judgment appealed from is hereby *REVERSED* and *SET ASIDE*, and another one entered *DISMISSING* the petition for naturalization. With costs against the petitioner-appellee, Felly Lee Fong Sheng.

SO ORDERED.

Melencio-Herrera (Chairman), Paras, Sarmiento, and *Regalado, JJ.*, concur.

FIRST DIVISION

[G.R. No. 78133. October 18, 1988]

MARIANO P. PASCUAL and RENATO P. DRAGON, *petitioners, vs.* **THE COMMISSIONER OF INTERNAL REVENUE and COURT OF TAX APPEALS,** *respondents.*

SYLLABUS

1. CIVIL LAW; PARTNERSHIP; HOW ESTABLISHED. — The sharing of returns does not in itself establish a partnership whether or not the persons sharing therein have a joint or common right or interest in the property. There must be a clear intent to form a partnership, the existence of a juridical personality different from the individual partners, and the freedom of each party to transfer or assign the whole property.

2. TAXATION; CORPORATE INCOME TAX; PARTIES IN CASE AT BAR NOT LIABLE FOR THE PAYMENT THEREOF. — In the present case, there is clear evidence of co-ownership between the petitioners. There is no adequate basis to support the proposition that they thereby formed an unregistered partnership. The two isolated transactions whereby they purchased properties and sold the same a few years thereafter

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did not thereby make them partners. They shared in the gross profits as co-owners and paid their capital gains taxes on their net profits and availed of the tax amnesty thereby. Under the circumstances, they cannot be considered to have formed an unregistered partnership which is thereby liable for corporate income tax, as the respondent commissioner proposes. As petitioners have availed of the benefits of tax amnesty as individual taxpayers in these transactions, they are thereby relieved of any further tax liability arising therefrom.

APPEARANCES OF COUNSEL

De la Cuesta, De las Alas & Callanta Law Offices for petitioners.

The Solicitor General for respondents.

D E C I S I O N

GANCAYCO, *J.*:

The distinction between co-ownership and an unregistered partnership or joint venture for income tax purposes is the issue in this petition.

On June 22, 1965, petitioners bought two (2) parcels of land from Santiago Bernardino, *et al.* and on May 28, 1966, they bought another three (3) parcels of land from Juan Roque. The first two parcels of land were sold by petitioners in 1968 to Marenir Development Corporation, while the three parcels of land were sold by petitioners to Erlinda Reyes and Maria Samson on March 19, 1970. Petitioners realized a net profit in the sale made in 1968 in the amount of ₱165,224.70, while they realized a net profit of ₱60,000.00 in the sale made in 1970. The corresponding capital gains taxes were paid by petitioners in 1973 and 1974 by availing of the tax amnesties granted in the said years.

However, in a letter dated March 31, 1979 of then Acting BIR Commissioner Efren I. Plana, petitioners were assessed and required to pay a total amount of ₱107,101.70 as alleged deficiency corporate income taxes for the years 1968 and 1970.

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Petitioners protested the said assessment in a letter of June 26, 1979 asserting that they had availed of tax amnesties way back in 1974.

In a reply of August 22, 1979, respondent Commissioner informed petitioners that in the years 1968 and 1970, petitioners as co-owners in the real estate transactions formed an unregistered partnership or joint venture taxable as a corporation under Section 20(b) and its income was subject to the taxes prescribed under Section 24, both of the National Internal Revenue Code;[1] that the unregistered partnership was subject to corporate income tax as distinguished from profits derived from the partnership by them which is subject to individual income tax; and that the availment of tax amnesty under P.D. No. 23, as amended, by petitioners relieved petitioners of their individual income tax liabilities but did not relieve them from the tax liability of the unregistered partnership. Hence, the petitioners were required to pay the deficiency income tax assessed.

Petitioners filed a petition for review with the respondent Court of Tax Appeals docketed as CTA Case No. 3045. In due course, the respondent court by a majority decision of March 30, 1987,[2] affirmed the decision and action taken by respondent commissioner with costs against petitioners.

It ruled that on the basis of the principle enunciated in *Evangelista*,[3] an unregistered partnership was in fact formed by petitioners which like a corporation was subject to corporate income tax distinct from that imposed on the partners.

In a separate dissenting opinion, Associate Judge Constante Roaquin stated that considering the circumstances of this case,

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[1] Annex "C" of the Petition, citing *Evangelista v. Collector*, G.R. No. 9996, Oct. 15, 1957, 102 Phil. 140.

[2] Penned by Presiding Judge Amante Filler, concurred in by Associate Judge Alex Z. Reyes, Associate Judge Roaquin dissented in a separate opinion.

[3] *Supra.*

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although there might in fact be a co-ownership between the petitioners, there was no adequate basis for the conclusion that they thereby formed an unregistered partnership which made them liable for corporate income tax under the Tax Code.

Hence, this petition wherein petitioners invoke as basis thereof the following alleged errors of the respondent court:

"A. IN HOLDING AS PRESUMPTIVELY CORRECT THE DETERMINATION OF THE RESPONDENT COMMISSIONER, TO THE EFFECT THAT PETITIONERS FORMED AN UNREGISTERED PARTNERSHIP SUBJECT TO CORPORATE INCOME TAX, AND THAT THE BURDEN OF OFFERING EVIDENCE IN OPPOSITION THERETO RESTS UPON THE PETITIONERS.

B. IN MAKING A FINDING, SOLELY ON THE BASIS OF ISOLATED SALE TRANSACTIONS, THAT AN UNREGISTERED PARTNERSHIP EXISTED, THUS IGNORING THE REQUIREMENTS LAID DOWN BY LAW THAT WOULD WARRANT THE PRESUMPTION/CONCLUSION THAT A PARTNERSHIP EXISTS.

C. IN FINDING THAT THE INSTANT CASE IS SIMILAR TO THE EVANGELISTA CASE AND THEREFORE SHOULD BE DECIDED ALONGSIDE THE EVANGELISTA CASE.

D. IN RULING THAT THE TAX AMNESTY DID NOT RELIEVE THE PETITIONERS FROM PAYMENT OF OTHER TAXES FOR THE PERIOD COVERED BY SUCH AMNESTY." (pp. 12-13, *Rollo*.)

The petition is meritorious.

The basis of the subject decision of the respondent court is the ruling of this Court in *Evangelista*.[4]

In the said case, petitioners borrowed a sum of money from their father which together with their own personal funds they used in buying several real properties. They appointed their brother to manage their properties with full power to lease,

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[4] *Supra*.

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collect, rent, issue receipts, *etc.* They had the real properties rented or leased to various tenants for several years and they gained net profits from the rental income. Thus, the Collector of Internal Revenue demanded the payment of income tax on a corporation, among others, from them.

In resolving the issue, this Court held as follows:

"The issue in this case is whether petitioners are subject to the tax on corporations provided for in Section 24 of Commonwealth Act No. 466, otherwise known as the National Internal Revenue Code, as well as to the residence tax for corporations and the real estate dealers' fixed tax. With respect to the tax on corporations, the issue hinges on the meaning of the terms 'corporation' and 'partnership' as used in Sections 24 and 84 of said Code, the pertinent parts of which read:

> 'Sec. 24. Rate of the tax on corporations. — There shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding taxable year from all sources by every corporation organized in, or existing under the laws of the Philippines, no matter how created or organized but not including duly registered general co-partnerships (*companias colectivas*), a tax upon such income equal to the sum of the following: ***.'

> 'Sec. 84(b). The term 'corporation' includes partnerships, no matter how created or organized, joint—stock companies, joint accounts (*cuentas en participation*), associations or insurance companies, but does not include duly registered general co-partnerships (*companias colectivas*).'

"Article 1767 of the Civil Code of the Philippines provides:

'By the contract of partnership two or more persons bind themselves to contribute money, property, or industry to a common fund, with the intention of dividing the profits among themselves.'

"Pursuant to this article, *the essential elements of a partnership are two, namely: (a) an agreement to contribute money, property or industry to a common fund; and (b) intent to divide the profits among the contracting parties.* The first element is undoubtedly present in the case at bar, for, admittedly, petitioners have agreed to, and did, contribute money and property to a common fund. *Hence,*

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the issue narrows down to their intent in acting as they did. Upon consideration of all the facts and circumstances surrounding the case, *we are fully satisfied that their purpose was to engage in real estate transactions for monetary gain and then divide the same among themselves*, because:

1. *Said common fund was not something they found already in existence.* It was not a property inherited by them *pro indiviso*. They *created it purposely*. What is more they jointly borrowed a substantial portion thereof in order to establish said common fund.

2. They *invested the same, not merely in one transaction, but in a series of transactions*. On February 2, 1943, they bought a lot for ₱100,000.00. On April 3, 1944, they purchased 21 lots for ₱18,000.00. This was soon followed, on April 23, 1944, by the acquisition of another real estate for ₱108,825.00. Five (5) days later (April 28, 1944), they got a fourth lot for ₱237,234.14. *The number of lots (24) acquired and transactions undertaken*, as well as the brief interregnum between each, particularly the last three purchases, *is strongly indicative of a pattern or common design that was not limited to the conservation and preservation of the aforementioned common fund or even of the property acquired by petitioners in February, 1943. In other words, one cannot but perceive a character of habituality peculiar to business transactions engaged in for purposes of gain.*

3. *The aforesaid lots were not devoted to residential purposes, or to other personal uses, of petitioners herein.* The properties were leased separately to several persons, who, from 1945 to 1948 inclusive, paid the total sum of ₱70,068.30 by way of rentals. Seemingly, the lots are still being so let, for petitioners do not even suggest that there has been any change in the utilization thereof.

4. Since August, 1945, *the properties have been under the management of one person*, namely, Simeon Evangelista, with full power to lease, to collect rents, to issue receipts, to bring suits, to sign letters and contracts, and to indorse and deposit notes and checks. *Thus, the affairs relative to said properties have been handled as if the same belonged to a corporation or business enterprise operated for profit.*

5. *The foregoing conditions have existed for more than ten (10) years, or, to be exact, over fifteen (15) years,* since the first property was acquired, and over twelve (12) years, since Simeon Evangelista became the manager.

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6. Petitioners have not testified or introduced any evidence, either on their purpose in creating the set up already adverted to, or on the causes for its continued existence. They did not even try to offer an explanation therefor.

Although, taken singly, they might not suffice to establish the intent necessary to constitute a partnership, *the collective effect of these circumstance is such as to leave no room for doubt on the existence of said intent in petitioners herein. Only one or two of the aforementioned circumstances were present in the cases cited by petitioners herein, and, hence, those cases are not in point.*"[5]

In the present case, there is no evidence that petitioners entered into an agreement to contribute money, property or industry to a common fund, and that they intended to divide the profits among themselves. Respondent commissioner and/or his representative just assumed these conditions to be present on the basis of the fact that petitioners purchased certain parcels of land and became co-owners thereof.

In Evangelista, *there was a series of transactions where petitioners purchased twenty-four (24) lots* showing that the purpose was not limited to the conservation or preservation of the common fund or even the properties acquired by them. *The character of habituality peculiar to business transactions engaged in for the purpose of gain was present.*

In the instant case, petitioners bought two (2) parcels of land in 1965. They did not sell the same nor make any improvements thereon. In 1966, they bought another three (3) parcels of land from one seller. It was only 1968 when they sold the two (2) parcels of land after which they did not make any additional or new purchase. The remaining three (3) parcels were sold by them in 1970. The transactions were isolated. The character of habituality peculiar to business transactions for the purpose of gain was not present.

In *Evangelista*, the properties were leased out to tenants for several years. The business was under the management of

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[5] *Supra*, pp. 144-146; italics supplied.

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one of the partners. Such condition existed for over fifteen (15) years. None of the circumstances are present in the case at bar. The co-ownership started only in 1965 and ended in 1970.

Thus, in the concurring opinion of Mr. Justice Angelo Bautista in *Evangelista* he said:

"I wish however to make the following observation: Article 1769 of the new Civil Code lays down the rule for determining when a transaction should be deemed a partnership or a co-ownership. Said article paragraphs 2 and 3, provides;

'(2) Co-ownership or co-possession does not itself establish a partnership, whether such co-owners or co-possessors do or do not share any profits made by the use of the property;

'(3) The sharing of gross returns does not of itself establish a partnership, whether or not the persons sharing them have a joint or common right or interest in any property from which the returns are derived;'

"*From the above it appears that the fact that those who agree to form a co-ownership share or do not share any profits made by the use of the property held in common does not convert their venture into a partnership. Or the sharing of the gross returns does not of itself establish a partnership whether or not the persons sharing therein have a joint or common right or interest in the property. This only means that, aside from the circumstance of profit, the presence of other elements constituting partnership is necessary, such as the clear intent to form a partnership, the existence of a juridical personality different from that of the individual partners, and the freedom to transfer or assign any interest in the property by one with the consent of the others* (Padilla, Civil Code of the Philippines Annotated, Vol. I, 1953 ed., pp. 635-636)

"*It is evident that an isolated transaction whereby two or more persons contribute funds to buy certain real estate for profit in the absence of other circumstances showing a contrary intention cannot be considered a partnership.*

'Persons who contribute property or funds for a common enterprise and agree to share the gross returns of that enterprise in proportion to their contribution, but who severally retain the title to their respective contribution, are not thereby rendered partners. They have no common stock or capital, and no community of interest as principal

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proprietors in the business itself which the proceeds derived. (Elements of the Law of Partnership by Floyd D. Mechem, 2nd Ed., Section 83, p. 74.)

'A *joint purchase of land, by two, does not constitute a co-*partnership in respect thereto; nor does an agreement to share the profits and losses on the sale of land create a partnership; the parties are only tenants in common.' (*Clark vs. Sideway,* 142 U.S. 682,12 Ct. 327, 35 L. Ed., 1157.)

'Where plaintiff, his brother, and another agreed to become owners of a single tract of realty, holding as tenants in common, and to divide the profits of disposing of it, the brother and the other not being entitled to share in plaintiff's commission, no partnership existed as between the three parties, whatever their relation may have been as to third parties.' (*Magee vs. Magee*, 123 N.E. 673, 233 Mass. 341.)

'In order to constitute a partnership inter sese there must be: (a) An intent to form the same; (b) generally participating in both profits and losses; (c) and such a community of interest, as far as third persons are concerned as enables each party to make contract, manage the business and dispose of the whole property.' — *Municipal Paving Co. vs. Herring*, 150 P. 1067, 50 III 470.)

'The common ownership of property does not itself create a partnership between the owners, though they may use it for the purpose of making gains; and they may, without becoming partners, agree among themselves as to the management, and use of such property and the application of the proceeds therefrom.' — (*Spurlock vs. Wilson*, 142 S.W. 363, 160 No. App. 14.)"[6]

The sharing of returns does not in itself establish a partnership whether or not the persons sharing therein have a joint or common right or interest in the property. There must be a clear intent to form a partnership, the existence of a juridical personality different from the individual partners, and the freedom of each party to transfer or assign the whole property.

In the present case, there is clear evidence of co-ownership between the petitioners. There is no adequate basis to support the proposition that they thereby formed an unregistered

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[6] *Supra*, pp. 150-151; italics supplied.

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partnership. The two isolated transactions whereby they purchased properties and sold the same a few years thereafter did not thereby make them partners. They shared in the gross profits as co-owners and paid their capital gains taxes on their net profits and availed of the tax amnesty thereby. Under the circumstances, they cannot be considered to have formed an unregistered partnership which is thereby liable for corporate income tax, as the respondent commissioner proposes.

And even assuming for the sake of argument that such unregistered partnership appears to have been formed, since there is no such existing unregistered partnership with a distinct personality nor with assets that can be held liable for said deficiency corporate income tax, then petitioners can be held individually liable as partners for this unpaid obligation of the partnership.[7] However, as petitioners have availed of the benefits of tax amnesty as individual taxpayers in these transactions, they are thereby relieved of any further tax liability arising therefrom.

WHEREFORE, the petition is hereby GRANTED and the decision of the respondent Court of Tax Appeals of March 30, 1987 is hereby REVERSED and SET ASIDE and another decision is hereby rendered relieving petitioners of the corporate income tax liability in this case, without pronouncement as to costs.

SO ORDERED.

Cruz, Griño-Aquino, and *Medialdea, JJ.*, concur.

Narvasa, J., No part by reason of relation to a party.

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[7] Article 1816. All partners, including industrial ones, shall be liable *pro rata* with all their property and after all the partnership assets have been exhausted, for the contracts which may be entered into in the name and for the account of the partnership, under its signature and by a person authorized to act for the partnership. However, any partner may enter into a separate obligation to perform a partnership contract. (Civil Code of the Philippines)

See also Articles 1817 and 1818, *Supra.*