FIRST DIVISION

[G.R. No. 147188. September 14, 2004]

COMMISSIONER OF INTERNAL REVENUE, *petitioner, vs.* THE ESTATE OF BENIGNO P. TODA, JR., Represented by Special Co-administrators Lorna Kapunan and Mario Luza Bautista, *respondents*.

D E C I S I O N

DAVIDE, JR., *C.J.*:

This Court is called upon to determine in this case whether the tax planning scheme adopted by a corporation constitutes tax evasion that would justify an assessment of deficiency income tax.

The petitioner seeks the reversal of the Decision[1] of the Court of Appeals of 31 January 2001 in CA-G.R. SP No. 57799 affirming the 3 January 2000 Decision[2] of the Court of Tax Appeals (CTA) in C.T.A. Case No. 5328,[3] which held that the respondent Estate of Benigno P. Toda, Jr. is not liable for the deficiency income tax of Cibeles Insurance Corporation (CIC) in the amount of ₱79,099,999.22 for the year 1989, and ordered the cancellation and setting aside of the assessment issued by Commissioner of Internal Revenue Liwayway Vinzons-Chato on 9 January 1995.

The case at bar stemmed from a Notice of Assessment sent to CIC by the Commissioner of Internal Revenue for deficiency income tax arising from an alleged simulated sale of a 16-storey commercial building known as Cibeles Building, situated on two parcels of land on Ayala Avenue, Makati City.

On 2 March 1989, CIC authorized Benigno P. Toda, Jr., President and owner of 99.991% of its issued and outstanding capital stock, to sell the Cibeles Building and the two parcels of land on which the building stands for an amount of not less than ₱90 million.[4]

On 30 August 1989, Toda purportedly sold the property for ₱100 million to Rafael A. Altonaga, who, in turn, sold the same property on the same day to Royal Match Inc. (RMI) for ₱200 million. These two transactions were evidenced by Deeds of Absolute Sale notarized on the same day by the same notary public.[5]

For the sale of the property to RMI, Altonaga paid capital gains tax in the amount of ₱10 million.[6]

On 16 April 1990, CIC filed its corporate annual income tax return[7] for the year 1989, declaring, among other things, its gain from the sale of real property in the amount of ₱75,728.021. After crediting withholding taxes of ₱254,497.00, it paid ₱26,341,207[8] for its net taxable income of ₱75,987,725.

On 12 July 1990, Toda sold his entire shares of stocks in CIC to Le Hun T. Choa for ₱12.5 million, as evidenced by a Deed of Sale of Shares of Stocks.[9] Three and a half years later, or on

16 January 1994, Toda died.

On 29 March 1994, the Bureau of Internal Revenue (BIR) sent an assessment notice[10] and demand letter to the CIC for deficiency income tax for the year 1989 in the amount of ₱79,099,999.22.

The new CIC asked for a reconsideration, asserting that the assessment should be directed against the old CIC, and not against the new CIC, which is owned by an entirely different set of stockholders; moreover, Toda had undertaken to hold the buyer of his stockholdings and the CIC free from all tax liabilities for the fiscal years 1987-1989.[11]

On 27 January 1995, the Estate of Benigno P. Toda, Jr., represented by special co-administrators Lorna Kapunan and Mario Luza Bautista, received a Notice of Assessment[12] dated 9 January 1995 from the Commissioner of Internal Revenue for deficiency income tax for the year 1989 in the amount of ₱79,099,999.22, computed as follows:

Income Tax – 1989

Net Income per return		₱75,987,725.00
Add: Additional gain on sale of real property taxable under ordinary corporate income but were substituted with individual capital gains (₱200M – 100M)		100,000,000.00
Total Net Taxable Income per investigation		₱175,987,725.00
Tax Due thereof at 35%		₱ 61,595,703.75
Less: Payment already made		
1. Per return	₱26,595,704.00	
2. Thru Capital Gains Tax made by R.A. Altonaga	10,000,000.00	36,595,704.00
Balance of tax due		₱ 24,999,999.75
Add: 50% Surcharge		12,499,999.88
25% Surcharge		6,249,999.94
Total		₱ 43,749,999.57
Add: Interest 20% from 4/16/90-4/30/94 (.808)		35,349,999.65
TOTAL AMT. DUE & COLLECTIBLE		₱ 79,099,999.22
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The Estate thereafter filed a letter of protest.[13]

In the letter dated 19 October 1995,[14] the Commissioner dismissed the protest, stating that a fraudulent scheme was deliberately perpetuated by the CIC wholly owned and controlled by Toda by covering up the additional gain of ₱100 million, which resulted in the change in the income structure of the proceeds of the sale of the two parcels of land and the building thereon to an individual capital gains, thus evading the higher corporate income tax rate of 35%.

On 15 February 1996, the Estate filed a petition for review[15] with the CTA alleging that the Commissioner erred in holding the Estate liable for income tax deficiency; that the inference of fraud of the sale of the properties is unreasonable and unsupported; and that the right of the Commissioner to assess CIC had already prescribed.

In his Answer[16] and Amended Answer,[17] the Commissioner argued that the two transactions actually constituted a single sale of the property by CIC to RMI, and that Altonaga was neither the buyer of the property from CIC nor the seller of the same property to RMI. The additional gain of ₱100 million (the difference between the second simulated sale for ₱200 million and the first simulated sale for ₱100 million) realized by CIC was taxed at the rate of only 5% purportedly as capital gains tax of Altonaga, instead of at the rate of 35% as corporate income tax of CIC. The income tax return filed by CIC for 1989 with intent to evade payment of the tax was thus false or fraudulent. Since such falsity or fraud was discovered by the BIR only on 8 March 1991, the assessment issued on 9 January 1995 was well within the prescriptive period prescribed by Section 223 (a) of the National Internal Revenue Code of 1986, which provides that tax may be assessed within ten years from the discovery of the falsity or fraud. With the sale being tainted with fraud, the separate corporate personality of CIC should be disregarded. Toda, being the registered owner of the 99.991% shares of stock of CIC and the beneficial owner of the remaining 0.009% shares registered in the name of the individual directors of CIC, should be held liable for the deficiency income tax, especially because the gains realized from the sale were withdrawn by him as cash advances or paid to him as cash dividends. Since he is already dead, his estate shall answer for his liability.

In its decision[18] of 3 January 2000, the CTA held that the Commissioner failed to prove that CIC committed fraud to deprive the government of the taxes due it. It ruled that even assuming that a pre-conceived scheme was adopted by CIC, the same constituted mere tax avoidance, and not tax evasion. There being no proof of fraudulent transaction, the applicable period for the BIR to assess CIC is that prescribed in Section 203 of the NIRC of 1986, which is three years after the last day prescribed by law for the filing of the return. Thus, the government's right to assess CIC prescribed on 15 April 1993. The assessment issued on 9 January 1995 was, therefore, no longer valid. The CTA also ruled that the mere ownership by Toda of 99.991% of the capital stock of CIC was not in itself sufficient ground for piercing the separate corporate personality of CIC. Hence, the CTA declared that the Estate is not liable for deficiency income tax of ₱79,099,999.22 and, accordingly, cancelled and set aside the assessment issued by the Commissioner on 9 January 1995.

In its motion for reconsideration,[19] the Commissioner insisted that the sale of the property owned by CIC was the result of the connivance between Toda and Altonaga. She further alleged that the latter was a representative, dummy, and a close business associate of the former, having held his office in a property owned by CIC and derived his salary from a foreign corporation (Aerobin, Inc.) duly owned by Toda for representation services rendered. The CTA denied[20] the motion for reconsideration, prompting the Commissioner to file a petition for review[21] with the Court of Appeals.

In its challenged Decision of 31 January 2001, the Court of Appeals affirmed the decision of the CTA, reasoning that the CTA, being more advantageously situated and having the necessary expertise in matters of taxation, is "better situated to determine the correctness, propriety, and legality of the income tax assessments assailed by the Toda Estate."[22]

Unsatisfied with the decision of the Court of Appeals, the Commissioner filed the present petition invoking the following grounds:

I. THE COURT OF APPEALS ERRED IN HOLDING THAT RESPONDENT COMMITTED NO FRAUD WITH INTENT TO EVADE THE TAX ON THE SALE OF THE PROPERTIES OF CIBELES INSURANCE CORPORATION.

II. THE COURT OF APPEALS ERRED IN NOT DISREGARDING THE SEPARATE CORPORATE PERSONALITY OF CIBELES INSURANCE CORPORATION.

III. THE COURT OF APPEALS ERRED IN HOLDING THAT THE RIGHT OF PETITIONER TO ASSESS RESPONDENT FOR DEFICIENCY INCOME TAX FOR THE YEAR 1989 HAD PRESCRIBED.

The Commissioner reiterates her arguments in her previous pleadings and insists that the sale by CIC of the Cibeles property was in connivance with its dummy Rafael Altonaga, who was financially incapable of purchasing it. She further points out that the documents themselves prove the fact of fraud in that (1) the two sales were done simultaneously on the same date, 30 August 1989; (2) the Deed of Absolute Sale between Altonaga and RMI was notarized ahead of the alleged sale between CIC and Altonaga, with the former registered in the Notarial Register of Jocelyn H. Arreza Pabelana as Doc. **91**, Page 20, Book I, Series of 1989; and the latter, as Doc. No. **92**, Page 20, Book I, Series of 1989, of the same Notary Public; (3) as early as 4 May 1989, CIC received ₱40 million from RMI, and not from Altonaga. The said amount was debited by RMI in its trial balance as of 30 June 1989 as investment in Cibeles Building. The substantial portion of ₱40 million was withdrawn by Toda through the declaration of cash dividends to all its stockholders.

For its part, respondent Estate asserts that the Commissioner failed to present the income tax return of Altonaga to prove that the latter is financially incapable of purchasing the Cibeles property.

To resolve the grounds raised by the Commissioner, the following questions are pertinent:

1. Is this a case of tax evasion or tax avoidance?

2. Has the period for assessment of deficiency income tax for the year 1989 prescribed? and

3. Can respondent Estate be held liable for the deficiency income tax of CIC for the year 1989, if any?

We shall discuss these questions *in seriatim.*

Is this a case of tax evasion or tax avoidance?

Tax avoidance and *tax evasion* are the two most common ways used by taxpayers in escaping from taxation. Tax avoidance is the tax saving device within the means sanctioned by law. This method should be used by the taxpayer in good faith and at arms length. Tax evasion, on the other hand, is a scheme used outside of those lawful means and when availed of, it usually subjects the taxpayer to further or additional civil or criminal liabilities.[23]

Tax evasion connotes the integration of three factors: (1) the end to be achieved, *i.e.,* the payment of less than that known by the taxpayer to be legally due, or the non-payment of tax when it is shown that a tax is due; (2) an accompanying state of mind which is described as being “evil,” in “bad faith,” “willfull,”or “deliberate and not accidental”; and (3) a course of action or failure of action which is unlawful.[24]

All these factors are present in the instant case. It is significant to note that as early as 4 May

1989, prior to the purported sale of the Cibeles property by CIC to Altonaga on 30 August 1989, CIC received ₱40 million from RMI,[25] and not from Altonaga. That ₱40 million was debited by RMI and reflected in its trial balance[26] as "other inv. – Cibeles Bldg." Also, as of 31 July 1989, another ₱40 million was debited and reflected in RMI's trial balance as "other inv. – Cibeles Bldg." This would show that the real buyer of the properties was RMI, and not the intermediary Altonaga.

The investigation conducted by the BIR disclosed that Altonaga was a close business associate and one of the many trusted corporate executives of Toda. This information was revealed by Mr. Boy Prieto, the assistant accountant of CIC and an old timer in the company.[27] But Mr. Prieto did not testify on this matter, hence, that information remains to be hearsay and is thus inadmissible in evidence. It was not verified either, since the letter-request for investigation of Altonaga was unserved,[28] Altonaga having left for the United States of America in January 1990. Nevertheless, that Altonaga was a mere conduit finds support in the admission of respondent Estate that the sale to him was part of the tax planning scheme of CIC. That admission is borne by the records. In its Memorandum, respondent Estate declared:

> Petitioner, however, claims there was a "change of structure" of the proceeds of sale. Admitted one hundred percent. But isn't this precisely the definition of tax planning? Change the structure of the funds and pay a lower tax. Precisely, Sec. 40 (2) of the Tax Code exists, allowing tax free transfers of property for stock, changing the structure of the property and the tax to be paid. As long as it is done legally, changing the structure of a transaction to achieve a lower tax is not against the law. It is absolutely allowed.
>
> Tax planning is by definition to reduce, if not eliminate altogether, a tax. Surely petitioner [*sic*] cannot be faulted for **wanting to reduce the tax from 35% to 5%**.[29] [Underscoring supplied].

The scheme resorted to by CIC in making it appear that there were two sales of the subject properties, *i.e.*, from CIC to Altonaga, and then from Altonaga to RMI cannot be considered a legitimate tax planning. Such scheme is tainted with fraud.

Fraud in its general sense, "is deemed to comprise anything calculated to deceive, including all acts, omissions, and concealment involving a breach of legal or equitable duty, trust or confidence justly reposed, resulting in the damage to another, or by which an undue and unconscionable advantage is taken of another."[30]

Here, it is obvious that the objective of the sale to Altonaga was to reduce the amount of tax to be paid especially that the transfer from him to RMI would then subject the income to only 5% individual capital gains tax, and not the 35% corporate income tax. Altonaga's sole purpose of acquiring and transferring title of the subject properties on the same day was to create a tax shelter. Altonaga never controlled the property and did not enjoy the normal benefits and burdens of ownership. The sale to him was merely a tax ploy, a sham, and without business purpose and economic substance. Doubtless, the execution of the two sales was calculated to mislead the BIR with the end in view of reducing the consequent income tax liability.

In a nutshell, the intermediary transaction, *i.e.*, the sale of Altonaga, which was prompted more on the mitigation of tax liabilities than for legitimate business purposes constitutes one of tax evasion.[31]

Generally, a sale or exchange of assets will have an income tax incidence only when it is consummated.[32] The incidence of taxation depends upon the substance of a transaction. The tax consequences arising from gains from a sale of property are not finally to be determined solely by the means employed to transfer legal title. Rather, the transaction must be viewed as a whole, and

each step from the commencement of negotiations to the consummation of the sale is relevant. A sale by one person cannot be transformed for tax purposes into a sale by another by using the latter as a conduit through which to pass title. To permit the true nature of the transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress.[33]

To allow a taxpayer to deny tax liability on the ground that the sale was made through another and distinct entity when it is proved that the latter was merely a conduit is to sanction a circumvention of our tax laws. Hence, the sale to Altonaga should be disregarded for income tax purposes.[34] The two sale transactions should be treated as a single direct sale by CIC to RMI.

Accordingly, the tax liability of CIC is governed by then Section 24 of the NIRC of 1986, as amended (now 27 (A) of the Tax Reform Act of 1997), which stated as follows:

Sec. 24. Rates of tax on corporations. – (a) Tax on domestic corporations.- A tax is hereby imposed upon the taxable net income received during each taxable year from all sources by every corporation organized in, or existing under the laws of the Philippines, and partnerships, no matter how created or organized but not including general professional partnerships, in accordance with the following:

Twenty-five percent upon the amount by which the taxable net income does not exceed one hundred thousand pesos; and

Thirty-five percent upon the amount by which the taxable net income exceeds one hundred thousand pesos.

CIC is therefore liable to pay a 35% corporate tax for its taxable net income in 1989. The 5% individual capital gains tax provided for in Section 34 (h) of the NIRC of 1986[35] (now 6% under Section 24 (D) (1) of the Tax Reform Act of 1997) is inapplicable. Hence, the assessment for the deficiency income tax issued by the BIR must be upheld.

Has the period of assessment prescribed?

No. Section 269 of the NIRC of 1986 (now Section 222 of the Tax Reform Act of 1997) read:

Sec. 269. Exceptions as to period of limitation of assessment and collection of taxes.-(a) In the case of a false or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed, or a proceeding in court after 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: **Provided,** That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for collection thereof… .

Put differently, in cases of (1) fraudulent returns; (2) false returns with intent to evade tax; and (3) failure to file a return, the period within which to assess tax is ten years from discovery of the fraud, falsification or omission, as the case may be.

It is true that in a query dated 24 August 1989, Altonaga, through his counsel, asked the Opinion of the BIR on the tax consequence of the two sale transactions.[36] Thus, the BIR was amply informed of the transactions even prior to the execution of the necessary documents to effect the transfer. Subsequently, the two sales were openly made with the execution of public documents and the declaration of taxes for 1989. However, these circumstances do not negate the

existence of fraud. As earlier discussed those two transactions were tainted with fraud. And even assuming *arguendo* that there was no fraud, we find that the income tax return filed by CIC for the year 1989 was false. It did not reflect the true or actual amount gained from the sale of the Cibeles property. Obviously, such was done with intent to evade or reduce tax liability.

As stated above, the prescriptive period to assess the correct taxes in case of false returns is ten years from the discovery of the falsity. The false return was filed on 15 April 1990, and the falsity thereof was claimed to have been discovered only on 8 March 1991.[37] The assessment for the 1989 deficiency income tax of CIC was issued on 9 January 1995. Clearly, the issuance of the correct assessment for deficiency income tax was well within the prescriptive period.

Is respondent Estate liable for the 1989 deficiency income tax of Cibeles Insurance Corporation?

A corporation has a juridical personality distinct and separate from the persons owning or composing it. Thus, the owners or stockholders of a corporation may not generally be made to answer for the liabilities of a corporation and vice versa. There are, however, certain instances in which personal liability may arise. It has been held in a number of cases that personal liability of a corporate director, trustee, or officer along, albeit not necessarily, with the corporation may validly attach when:

1. He assents to the (a) patently unlawful act of the corporation, (b) bad faith or gross negligence in directing its affairs, or (c) conflict of interest, resulting in damages to the corporation, its stockholders, or other persons;
2. He consents to the issuance of watered down stocks or, having knowledge thereof, does not forthwith file with the corporate secretary his written objection thereto;
3. He agrees to hold himself personally and solidarily liable with the corporation; or
4. He is made, by specific provision of law, to personally answer for his corporate action.[38]

It is worth noting that when the late Toda sold his shares of stock to Le Hun T. Choa, he knowingly and voluntarily held himself personally liable for all the tax liabilities of CIC and the buyer for the years 1987, 1988, and 1989. Paragraph g of the Deed of Sale of Shares of Stocks specifically provides:

g. Except for transactions occurring in the ordinary course of business, Cibeles has no liabilities or obligations, contingent or otherwise, for taxes, sums of money or insurance claims other than those reported in its audited financial statement as of December 31, 1989, attached hereto as "Annex B" and made a part hereof. The business of Cibeles has at all times been conducted in full compliance with all applicable laws, rules and regulations. **SELLER undertakes and agrees to hold the BUYER and Cibeles free from any and all income tax liabilities of Cibeles for the fiscal years 1987, 1988 and 1989.**[39] [Underscoring Supplied].

When the late Toda undertook and agreed "to hold the BUYER and Cibeles free from any all income tax liabilities of Cibeles for the fiscal years 1987, 1988, and 1989," he thereby voluntarily held himself personally liable therefor. Respondent estate cannot, therefore, deny liability for CIC's deficiency income tax for the year 1989 by invoking the separate corporate personality of CIC,

since its obligation arose from Toda's contractual undertaking, as contained in the *Deed of Sale of Shares of Stock.*

WHEREFORE, in view of all the foregoing, the petition is hereby GRANTED. The decision of the Court of Appeals of 31 January 2001 in CA-G.R. SP No. 57799 is REVERSED and SET ASIDE, and another one is hereby rendered ordering respondent Estate of Benigno P. Toda Jr. to pay ₱79,099,999.22 as deficiency income tax of Cibeles Insurance Corporation for the year 1989, plus legal interest from 1 May 1994 until the amount is fully paid.

Costs against respondent.

SO ORDERED.

Quisumbing, Ynares-Santiago, Carpio, and *Azcuna, JJ.,* concur.

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[1] *Rollo*, 22-31. Per Associate Justice Rodrigo *V.* Cosico, with Associate Justices Ramon A. Barcelona and Alicia J. Santos concurring.

[2] *Id*., 32-41; CTA Records, 524-533. Per Presiding Judge Ernesto D. Acosta, with Associate Judges Ramon O. De Veyra and Amancio Q. Saga concurring.

[3] Entitled "*The Estate of Benigno P. Toda, Jr., represented by Special Co-Administrators Lorna Patajo-Kapunan and Mario Luza Bautista versus Commissioner of Internal Revenue.*"

[4] CA *Rollo*, 73.

[5] CA *Rollo*, 74-78; 88-92.

[6] Exh. "E," CTA Records, 306.

[7] Exh. "L," CTA Records, 340.

[8] Exh. "M," "M-1," "N" and "N-1," CTA Records, 316-317.

[9] Exh. "P," CTA Records, 357-365.

[10] BIR Records, 448-449.

[11] *Id.*, 446-447.

[12] *Id.*, 474-475.

[13] Exh. "H," CTA Records, 314-315.

[14] Exh. "G," CTA Records, 311-312.

[15] CTA Records, 1-15.

[16] CTA Records, 104-111.

[17] *Id*., 121-128.

[18] CTA Records 535-540.

[19] *Id.*, 534, 539.

[20] *Id.,* 550; CA *Rollo*, 32.

[21] CA *Rollo*, 7-20.

[22] *Rollo*, 30.

[23] Jose C. Vitug and Ernesto D. Acosta, Tax Law and Jurisprudence 44 (2nd ed., 2000) (hereafter Vitug).

[24] DE LEON, FUNDAMENTALS OF TAXATION 53 (1988 ed.), citing Batter, Fraud under Federal Tax Law 15 (1953 ed.).

[25] Exh. "3," CTA Records, 476.

[26] Exh. "6," CTA Records, 470.

[27] Exh. "1," CTA Records, 461.

[28] CTA Records, 466.

[29] Respondent's Memorandum, 4-5; *Rollo*, 78-79.

[30] Commissioner of Internal Revenue *v.* Court of Appeals, 327 Phil. 1, 33 (1996).

[31] *See* Commissioner of Internal Revenue *v.* Norton Harrison Co., 120 Phil. 684, 691 (1964); Commissioner of Internal Revenue *v.* Rufino, G.R. No. L-33665-68, 27 February 1987, 148 SCRA 42.

[32] VITUG, 138.

[33] Commissioner *v.* Court Holding Co., 324 U.S. 334 (1945).

[34] *See* Gregory *v.* Helvering, 293 U.S. 465 (1935); Frank Lyon Co. *v.* United States, 435 U.S. 561 (1978); Commissioner of Internal Revenue *v.* Court of Appeals, 361 Phil. 103, 126 (1999) *citing* Asmussen *v.* CIR, 36 B.T.A. (F) 878; *See* also Neff *v.* U.S., 301 F2d 330; Cohen *v.* U.S., 192 F Supp 216; Herman *v.* Comm., 283 F2d 227; Kessner *v.* Comm., 248 F2d 943; Comm. *V.* Pope, 239 F2d 881; U.S. *v.* Fewel, 255 F2d 396.

[35] Sec. 34. Capital gains and loses.

. . .

(h) The provisions of paragraph (b) of this section to the contrary notwithstanding, sales, exchanges or other dispositions of real property classified as capital assets, including *pacto-de-retro* sales and other forms of conditional sale, by individuals, including estates and trusts, shall be taxed at the rate of 5% based on the gross selling price or the fair market value prevailing at the time of sale, whichever is higher.

[36] Exh. "A," CTA Records, 296.

[37] Exh. "2," CTA Records, 464.

[38] Atrium Management Corporation *v.* Court of Appeals, G.R. Nos. 109491 and 121794, 28 February 2001, 353 SCRA 23, 31, *citing* FCY Construction Group Inc. *v.* Court of Appeals, G.R. No. 123358, 1 February 2000, 324 SCRA 270.

[39] CTA Records, 200-201.