REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

DAIICHI CHUO KISEN
KAISHA,
Petitioner,

-versus- C.T.A. CASE NO. 1277

COMMISSIONER OF
INTERNAL REVENUE,
Respondent.
x- - - - - - - - - - - - -x May 31/69

D E C I S I O N

This is a petition for review of the decision of respondent Commissioner of Internal Revenue dated September 4, 1962 holding petitioner Daiichi Chuo Kisen Kaisha liable for deficiency income tax for the year 1957 in the amount of ₱31,339.44.

There is no dispute as to the facts.

Petitioner is a foreign shipping corporation organized under the laws of Japan and represented in the Philippines by its general agent, the Everett Steamship Corporation, with business address at 245 Juan Luna St., Manila. It is the merged and continuing corporation resulting from the consolidation of two Japanese corporations, i.e., the "Daiichi Kisen Kabushiki Kaisha" and the "Chuoh Kisen Kaisha" which, in 1957, were two separate and existing corporations. From the said amalgamation which was accomplished in Japan and made effective as of October 1, 1960, petitioner has succeeded to, and assumed all the rights, obligations, assets and liabilities of, the consolidated corporations, including the subject matter of the herein petition for review.

Before the consolidation of Daiichi Kisen Kabushiki Kaisha and Chuoh Kisen Kaisha, the latter, on June 29, 1957, filed its income tax return for the fiscal year ended March 31, 1957, reporting therein the sum of ¥544,108,493 as gross freight revenue derived in the Philippines and ₱6,023.00 as the amount of income tax due thereon. After verification of the said return, respondent assessed against petitioner on June 14, 1962 deficiency income tax for the year 1957 the amount of ₱31,339.44, inclusive of interest, for the period from June 20, 1959 to June 14, 1962. The deficiency assessment is the result of (a) the inclusion of the profit realized from the sale of petitioner's fixed assets abroad during the taxable year 1957 in the amount of ¥29,325,204 as part of its world's gross income under the formula of general apportionment set out in Section 163 of the Income Tax Regulations, otherwise known as Revenue Regulations No. 2; and (b) the disallowance of the sum of ¥22,969,639, representing "miscellaneous payments", which the company claimed as part of its world expenses.

On July 13, 1962 petitioner contested the aforesaid assessment, but its protest was denied by respondent in his letter dated September 4, 1962. Hence, this appeal.

The issues are:

> (a) Whether or not the amount of ¥29,325,204, representing profits realized from the sale in 1957 of fixed assets located abroad, is includible in petitioner's world gross income for purposes of computing its taxable net income from Philippine sources for the year 1957 under the formula of general apportionment provided in Section 163 of Revenue Regulations No. 2; and
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> (b) Whether or not the disallowance of the sum of ¥22,969,639 claimed by petitioner as part of its world expenses is proper.

The law classifies the income of foreign corporations into three: (1) income which is derived in full from sources within the Philippines; (2) income which is derived in full from sources without the Philippines; and (3) income which is derived partly from sources within and partly from sources without the Philippines. Non-resident alien individuals and foreign corporations, like petitioner herein, are taxable only on income from sources within the Philippines. The taxable income of foreign corporations from sources within the Philippines includes those derived in full from sources within the Philippines and that portion of the income which is derived partly from sources within and partly from sources without the Philippines which is allocable to sources within the Philippines. (Sec. 37, Revenue

Code; Sec. 152, Rev. Regs. No. 2.)

Section 37(a) of the Tax Code defines and enumerates in detail the various items of gross income derived or earned from sources within the Philippines. And from these items of gross income which are treated as income from sources within the Philippines, there are allowed to be deducted the expenses, losses and other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, is included in full as net income from sources within the Philippines. (Sec. 37(b), id.)

On the other hand, Section 37(c) of the same Code defines and enumerates the items of gross income which constitute income from sources without the Philippines. And from these items of gross income in Section 37(c) treated as income from sources without the Philippines, there are deducted the expenses, losses and other deductions properly apportioned or allocated thereto, and a ratable part of any expenses, losses or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, is treated in full as net income from sources without the Philippines. (Sec. 37(d), id.)

Some items of gross income considered derived from sources partly within and partly without the Philippines are: (1) gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the Philippines and sold within a foreign country, or produced (in whole or in part) by the taxpayer within a foreign country and sold within the Philippines (Sec. 162, Rev. Regs. No. 2); (2) gross receipts of foreign steamship companies whose vessels touch ports of the Philippines (Sec. 163, id.); and (3) the gross income of foreign corporations carrying on the business of transmission of telegraph or cable messages between points in the Philippines and points outside the Philippines (Sec. 164, id.). The net income is computed by deducting the expenses, losses, or other deductions apportioned or allocated thereto and a ratable part of any expenses, losses or other deductions which cannot definitely be allocated to some items or class of gross income; and the portion of such net income attributable to sources within the Philippines is determined by processes or formulas of general apportionment prescribed by the Secretary of Finance. (Secs. 162-164, id.) And since petitioner herein is a foreign shipping corporation whose vessels touch Philippine ports, the formula of general apportionment set out in Section 163, Revenue

Regulations No. 2, is the one applicable.

It will be noted that under Section 37(e) of the Revenue Code, only items of gross income falling under the third classification, i.e., income from sources partly within and partly without the Philippines should be allocated or apportioned to sources within or without the Philippines in accordance with Sections 162, 163 and 164 of Revenue Regulations No. 2. Thus, the first part of Section 37(e) states:

> "Items of gross income, expenses, losses and deductions, other than those specified in subsections (a) and (c) of this section shall be allocated or apportioned to sources within or without the Philippines, under the rules and regulations prescribed by the Secretary of Finance. x x x"

And Section 165 of Revenue Regulations No. 2 expressly provides:

> "Section 165. Computation of Income. If a taxpayer has gross income from sources within or without the Philippines as defined by section 37(a) or (c) together with gross income derived partly from sources within and partly from sources without the Philippines, the amounts thereof, together with the expenses and investment applicable thereto, shall be segregated, and the net income from sources within the Philippines shall be separately computed therefrom. (Underscoring supplied.)

In the light of the above, it seems plain that respondent cannot include income which is clearly derived in full from sources without the Philippines in the computation of income which is derived partly from sources within and partly from sources without the Philippines. For purposes of income taxation, respondent has apparently overlooked the classification into three distinct divisions the income of nonresident aliens and foreign corporations, like petitioner herein, which under Section 165, referred to above, must be segregated, together with the expenses and investments applicable thereto, and the net income computed separately.(Section 37 of the Revenue Code, as also shown above, plainly differentiates these three classes of incomes, and under subsection (e) thereof, only items of gross income, expenses, losses and deductions specified under the third category, i.e., income from sources partly within and partly without the Philippines, should be allocated or apportioned to sources within and without the Philippines in accordance with the rules and regulations prescribed by the Secretary of Finance. Since there is no question that petitioner's profits realized from the sale of its fixed assets located abroad in the amount of ¥29,325,204 are income clearly from sources without the Philippines, they are therefore excludible from the world gross income of the company for the purpose of determining its Philippine income under Section 163 of Revenue Regulations No. 2.)

Furthermore, it should be noted that in the formula of general apportionment under Section 163 of Revenue Regulations No. 2, the numerator, viz., P.I. gross income, includes only gross receipts of all outgoing business whether freights or passengers from Philippine ports, including income of a nonshipping character but incidental to the shipping business received by the Philippine office. On the other hand, the denominator, viz., world's gross income, includes gross income from all ports, both within and without the Philippines of all vessels, whether touching ports of the Philippines, including income of a nonshipping character but incidental to the shipping business, received by all offices. Accordingly, as petitioner claims, it would be improper to allocate the company's world expenses based on a formula which includes in the numerator and denominator incomes which bear no relationship to the expenses being allocated or apportioned.(The inclusion by respondent in petitioner's world gross income of the amount of ¥29,325,204, representing profits realized from the sale of fixed assets located abroad, which is not income from freights or passengers or incidental to the company's shipping business and which is clearly from sources without the Philippines, is therefore erroneous.

Respondent, however, argues that the phrase "world gross income" denotes not only gross income realized within the Philippines but also includes other incomes from all sources "including in each case income of a nonshipping character but incidental to the shipping business such as dividends from investments, interest on deposits." (Sec. 163, Rev. Regs. No. 2.) Again, respondent seems to have lost sight of the division by the law of income of taxpayers into three distinct classes (Sec. 152, Rev. Regs. No. 2; Sec. 37, Revenue Code), which is specially significant to petitioner herein as a foreign corporation deriving income from sources within the Philippines. As already shown above, under Section 37(e) of the Revenue Code, only items of gross income coming under the third classification, i.e., income from sources partly within and partly without the Philippines, should be allocated or apportioned to sources within or without the Philippines in accordance with Section 163 of Revenue Regulations No. 2. Consequently, where an item of income is directly classified as income which is derived in full from sources within the Philippines or income which is derived in full from sources without the Philippines under the provisions of Section 37(a) or (c) of the Tax

Code, in relation to Section 152 of Revenue Regulations No. 2, then Section 37(e) of the same Code, as well as the provisions of Section 163 of Revenue Regulations No. 2, cannot apply. Inasmuch as there is no question that petitioner's profits realized from the sale of its fixed assets located abroad are income derived in full from sources without the Philippines under Section 37(c), it follows that the said profits are not subject to allocation or apportionment to sources within or without the Philippines in accordance with Section 163 of Revenue Regulations No. 2. Because of the inapplicability of the said Section 163, we can see no materiality in respondent's argument that the phrase "world gross income" denotes not only gross income realized within the Philippines but also includes other incomes from all sources "including in each case income of a nonshipping character but incidental to the shipping business such as dividends from investments, interest on deposits."

At any rate, it was the intention of Congress to place the taxation of transportation companies upon a sounder and more scientific basis, and so the principle was adopted of considering income derived from transportation to be income for services, with the result that the place where the services are rendered determines the source. The result is income from sources partly within and partly without the Philippines under Section 37(e) of the National Internal Revenue Code. But the problem was not yet solved. It was still necessary to allocate income to the two sources. (See Mertens' Law of Federal Income Taxation, Vol. 8, Sec. 45.43, p. 112.) For this reason, we have the formula of general allocation or apportionment set out in Section 163 of Revenue Regulations No. 2. The term "including in each case income of a nonshipping character but incidental to the shipping business, such as dividends from investments, interests on deposits," should be limited to incidental income in connection with the service of transportation derived by foreign shipping companies whose vessels touch Philippine ports, and which is not income derived in full from sources without the Philippines under Section 37(e) of the Revenue Code. Otherwise, the inclusion of income which is not derived from the service of transportation and which is income from sources clearly without the Philippines in the phrase "world gross income" under the formula of general apportionment set out in Section 163 of the Income Tax Regulations for the purpose of determining Philippine taxable income, as respondent theorizes, will result in the taxation of property or activities beyond the taxing jurisdiction of the Philippines.)

Coming to the second issue, petitioner assails the disallowance by respondent of a portion of its world's gross miscellaneous expenses in the sum of ¥22,969,639 on the ground that the said amount represents ordinary and necessary expenses incurred in the course of its business and therefore deductible under Section 30(a) of the Revenue Code. A breakdown of such payments is as follows:

Allowance for retired seamen	¥9,032,933
Payment of capital increment	7,910,844
Bad debts	4,429,613
Brokerage for sale of vessels	1,000,000
Loss from sale of stocks	518,279
Arrears in tax for fixed assets	77,970
T o t a l ----------	¥22,969,639

And the reason which prompted respondent to disallow these expenses is stated in his letter dated September 4, 1962 to petitioner, the pertinent portion of which is quoted below:

> "With respect to the disallowance by our Examiner of the miscellaneous expense as an allowable part of the world expenses, based on the analysis of the financial statements submitted by your client, please be also informed that you failed to present concrete proof to support your contention that such findings by our Examiner is erroneous." (pp. 57-58, BIR rec.)

(To state a well-settled rule, it is incumbent upon the taxpayer to clearly show that the assessment is erroneous in order to relieve himself from it. (Collector of Internal Revenue vs. Bohol Land Transportation Co., 107 Phil. 965.) This is based on the now familiar principle in taxation that the assessment of the Commissioner of Internal Revenue is prima facie correct and the burden of proof is upon the taxpayer to overcome the presumption of its correctness. (Manila Railroad Co. vs. Collector of Customs, 52 Phil. 950; Jose Espino vs. Commissioner of Internal Revenue, CTA Case No. 1532, Jan. 21, 1969; Congragacion de la Mission de San Vicente de Paul vs. Commissioner of Internal Revenue, CTA Case No. 1468, May 19, 1969.) In appeals to the Court of Tax Appeals, the determination of the Commissioner of Internal Revenue is presumed correct and it behooves the taxpayer to rebut such presumption. (Tan Guan vs. Court of Tax Appeals, G.R. No. L-23676, April 27, 1967.) Moreover, the taxpayer must show that its claimed deductions clearly come within the language of the law, since deductions, like exemptions, are matters of legislative grace (Mertens, op. cit., Vol. 4, 1958 Ed., Sec. 25.03, Chap. 25, pp. 7, 8-9; Mertens, Ibid., Vol. I, 1956 Ed., Sec. 3.09, Chap. 3, pp. 15-16; Capitol Indemnity Insurance Co. vs. Commissioner of Internal Revenue, 25 BTA 147, 150; Congregacion de la Mision de San Vicente de Paul vs. Commissioner of Internal Revenue, CTA Case

No. 1468, May 19, 1969). Since petitioner presented no evidence to prove its contention that each of the above-enumerated items constitutes ordinary and necessary business expenses deductible under Section 30 of the Revenue Code, the disallowance by respondent of the amount of ¥22,969,639, representing "miscellaneous payments" made by petitioner during the taxable period ended March 31, 1957 must be sustained.)

In the light of the above, the decision of respondent should be modified in the sense that petitioner is liable for deficiency income tax and interest for the year 1957 in the amount of ₱12,243.91, computed as follows:

Net income per return	₱30,117.35
Additional Income:	
Additional Phil income ¥9,346,386 (¥180 per ₱1.00)	51,924.36
Net income	₱82,041.71
Tax due thereon	16,408.00
Less: Amount already assessed	6,023.00
Balance	₱10,385.00
Add: 1/2% monthly interest from 6/20/59 to 6/14/62	1,858.91
Deficiency tax due	₱12,243.91

WHEREFORE, the decision appealed from is hereby modified. Petitioner Daiichi Chuo Kisen Kaisha is ordered to pay respondent Commissioner of Internal Revenue deficiency income tax in the amount of ₱12,243.91 for the year 1957, inclusive of the 1/2% monthly interest pursuant to Section 51(d) of the

National Internal Revenue Code, as amended by Republic Act No. 2343. If the deficiency tax is not paid in full within thirty (30) days from the date this decision becomes final and executory, petitioner shall pay a surcharge of five per cent (5%) of the unpaid amount, plus interest at the rate of one per cent (1%) a month, computed from the date this decision becomes final until paid, provided that the maximum amount that may be collected as interest shall in no case exceed the amount corresponding to a period of three (3) years. Without pronouncement as to costs.

SO ORDERED.

Quezon City, May 31, 1969.

ROMAN M. UMALI
Presiding Judge

I CONCUR:

RAMON L. AVANCEÑA
Associate Judge