LIMPAN INVESTMENT
CORPORATION,
Petitioner,

-versus-

C.T.A. Case No. 1397

THE COLLECTOR OF
INTERNAL REVENUE,
Respondent.
x- - - - - - - - - - - -x

Dec. 11 '67

D E C I S I O N

This is an appeal from the decision of the Collector of Internal Revenue (now Commissioner) assessing against and demanding from petitioner payment of ₱10,149.44 as 1960 deficiency income tax, inclusive of interest.

Petitioner, a domestic corporation engaged in real estate business, filed its 1960 income tax return and declared therein a gross income of ₱261,130.88 and a net taxable income of ₱91,554.88 (Exh. 1, pp. 3-4, BIR rec.).

After a routine investigation of the said income tax return, Examiner Vicente F. Tan, Jr. recommended on January 31, 1962 (Exh. 3, p. 19 BIR rec.) that the expenses claimed in petitioner's return be disallowed, namely:

(a) Bonuses - - - - - - - - -	₱10,460.00
(b) Interest expenses - - -	20,000.00
(c) Entertainment expenses-	380.00
(d) Christmas expense - - -	1,113.85
(e) Miscellaneous expenses-	523.00
	₱32,477.75

On the basis of the recommendation of said examiner, respondent assessed against and demanded from petitioner payment of the 1960 deficiency income tax of ₱9,062.00, plus ₱1,087.44 as 1/2% monthly interest from April 15, 1961 to April 16, 1963 or a total of ₱10,149.44 (Exhs. 3, 4, 5, 7 & 8, BIR rec.).

From the said assesement, petitioner appealed to this Court and disputed the legality and correctness thereof.

The only issue submitted to the Court for resolution is whether or not bonuses, interest, entertainment, Christmas and miscellaneous expenses are deductible from petitioner's gross income in 1960 under Section 30 of the National Internal Revenue Code.

FIRST ISSUE:

Bonus payment of ₱10,460.00.- In 1960, petitioner had a gross income of ₱261,130.88 and a net income of ₱91,594.88, showing an increase of ₱62,000.00 in gross income over that of the previous year (p. 94, t.s.n., Session of September 1, 1966). The said petitioner paid bonuses of ₱13,000.00 to the following:

Recipients	Amount
Isabelo P. Lim	₱ 4,000.00
Purificacion C. Lim	4,000.00
Vicente G. Solis	2,000.00
R. B. Grengia	1,500.00
V. C. Manipol	1,500.00
	₱13,000.00

which were deducted from its 1960 gross income.

Of the ₱13,000.00 claimed as bonus deduction, ₱10,460.00 was disallowed by respondent. In other words, only ₱2,540.00, which is equivalent to the total average monthly salaries of the recipients, was allowed as a deduction. The sum of ₱10,460.00 was disallowed due to respondent's findings that the recipients thereof were only performing ordinary duties without rendering additional services which increased or tended to increase the gross income of petitioner; that Isabelo P. Lim and his wife, Purificacion G. Lim, own 90% of the capital stock of petitioner and the bonuses received by them were in fact dividend distributions because they were in proportion to their respective stock holdings; that Purificacion G. Lim was not actively engaged in the management of the affairs of the corporation; and that the bonuses were granted for the purpose of reducing the tax liability of the petitioner.

To be deductible, (1) the bonus must be in fact additional compensation; (2) it must be paid for personal services actually rendered; and (3) when added to salaries, the bonus must be reasonable by considering the value and quality of the services performed in relation to the taxpayer's business (Mertens, Law of

Federal Income Taxation, Vol. 4, Sec. 25.44, p. 395; Sec. 79, Rev. Regs. No. 2). The standard test for determining the reasonableness of the amount of compensation is the "value of the service" (Mertens, ibid., Sec. 23.54, p. 415). However, where there is no standard available by which the reasonability of the bonus deduction can be determined, it will depend upon various factors: (1) the amount and quality of the services performed in relation to the taxpayer's business; (2) the payment must be made in good faith; (3) the character of the taxpayer's business; (4) the volume and amount of its net earnings; (5) the locality of the business and the type and the extent of services rendered; (6) the salary policy of the corporation; (7) the employee's qualifications and contribution to the business venture; and (8) the general economic conditions prevailing in the place of business. (Mertens, ibid., Secs. 25.44, 25.49, 25.50, 25.51, pp. 407-412; Kuenzle & Streiff, Inc. vs. The Coll. of Int. Rev., G.R. Nos. L-12010 & 12113, Oct. 20, 1959; Florencio Reyes vs. Coll. of Int. Rev., C.T.A. Case No. 4, Sept. 30, 1957; Manila Publishing Co., vs. The Coll. of Int. Rev., C.T.A. Case No. 346, Dec. 26, 1958; Gladstone-Arcuni, Inc. TC Memo 1962, 185). (If there is a fair return in the investment after payment of bonus compensation, such fact is proof of the reasonability of the compensation) (Mertens, Law of Federal Income Taxation, Vol. 4, 1960 Ed., Sec. 2574, Chapt. 25, pp. 231-232).

There is no question that the bonuses paid to the officers of petitioner were in fact additional compensation for personal services actually rendered by them. The only question, therefore, for resolution relates to the reasonability of the bonus granted by petitioner to its officers.

The recipients of the bonus received the following annual salaries: Isabelo P. Lim, President and Manager, ₱18,000.00; Purificacion C. Lim, Vice-President and Assistant Manager, ₱6,000.00; Vicente G. Solis, Accountant and Secretary-Treasurer, ₱2,400.00; R. B. Grengia, Cashier, ₱2,160.00; and V. C. Manipol, officer-in-charge of legal cases, ₱1,920.00. They have rendered services as officers of petitioner since its organization in 1955 up to 1960.

In 1960, petitioner had a gross income of ₱261,130.88 showing an increase of ₱62,000.00 over that of the previous year. The increase in petitioner's gross income attests and may be attributed to the commendable and satisfactory services performed by the corporate officers to the business of petitioner.

Hence, the grant of bonus to the officers of the corporation is justified.

The bonus paid to Isabelo P. Lim, the President and Manager, represents only 4.368% of petitioner's net income for 1960; to Purification C. Lim, Vice-President and Assistant Manager, 4.368%; to Vicente G. Solis, Accountant and Secretary-Treasurer, 2.184%; to R. B. Grengia, Cashier, 1.638%; and to V. C. Manipol, officer-in-charge, 1.638%. It is clear, therefore, that the total amount of ₱13,000.00 paid as bonus to the officers of petitioner represents only 14.19% of its net income for 1960. Under the circumstance, it can be seen that a fair return in petitioner's investment has resulted after payment of the bonus compensation. And this fair return in the investment argues well for the reasonability of the bonus paid to Isabelo P. Lim, the President and Manager; Vicente G. Solis, Accountant and Secretary-Treasurer; R. B. Grengia, Cashier; and V. C. Manipol, Officer-in-charge. However, with respect to the bonus of ₱4,000.00 paid to Purificacion C. Lim, Vice-President of petitioner, we believe that only ₱1,800.00 should be allowed as a deduction from petitioner's gross income in 1960 because the services rendered by her to the corporation were not as extensive as are ordinarily expected of an officer similarly situated. There is an uncontradicted evidence that Mrs. Purificacion C. Lim was not seen in the office of petitioner for one month that respondent's examiner was investigating petitioner's books of accounts and income tax returns (see t.s.n., pp. 87-88, Session of September 1, 1966), thereby indicating that she was not performing her duties regularly. Moreover, where the question of reasonableness of salaries is put in issue, the burden of proving rests solely on the taxpayer (Allie Tuberville, 31 BTA 283, aff'd 84 F(2d) 307; Edgar Carnrick, 21 BTA 12,21; National Contracting Co., 37 BTA 689, aff'd 105 F(2d) 488). On this count, petitioner failed to prove its case.

SECOND ISSUE:

Interest expense of ₱20,000.00.- The evidence shows that Mrs. Vicenta Vda. de Lim transferred real properties valued at ₱312,000.00 and cash of ₱221,000.00 to her son, Isabelo P. Lim, who is the President of petitioner corporation (pp. 18 & 40, t.s.n., Session of September 1, 1966). Isabelo P. Lim, in turn, transferred to petitioner the said properties and cash without consideration (pp. 51-52, t.s.n., Session of Aug. 29, 1966), after a partial liquidation made in 1958. Petitioner treated the said transfer of properties and cash as a loan of ₱500,000.00. In a board resolution dated October 11, 1956, petitioner's directors resolved that the real properties transferred to petitioner should remain in its books of accounts as a loan to the corporation until such time as the Board of Directors may decide the final disposition of such obligation. Subsequently, on account of an alleged indebtedness to his mother, Vicenta Vda. de Lim, Isabelo P. Lim caused the transfer to her of his credit balance of ₱500,000.00 with the corporation (pp. 40, 58, t.s.n., Session of September 1, 1966), in partial satisfaction of his monetary obligation (pp. 36-37, t.s.n., Session of Aug. 1, 1966). On December 15, 1961, petitioner, through its President and Secretary-Treasurer, executed a certificate (Exh. E), affirming its debt of ₱500,000.00 to Vicenta Vda. de Lim and obligating itself to pay 4% annual interest thereon. Consequently, in 1960, petitioner paid ₱20,000.00 as interest on the amount of ₱500,000.00, the deduction of which was disallowed by respondent.

During the hearing, it was personally admitted by Isabelo P. Lim that the transfer of his credit with the petitioner to his mother was a personal transaction between them (p. 68, t.s.n., Session of Sept. 1, 1966).

The question, therefore, is whether or not the ₱20,000.00 paid by petitioner to Vicenta Vda. de Lim is a deductible interest expense of the corporation. In retrospect, it may be stated that the credit amounting to ₱500,000.00 of Isabelo P. Lim against petitioner was the same credit that was transferred to Doña Vicenta Vda. de Lim. The disallowed interest of ₱20,000.00 was paid on this transferred credit. (However, there is no showing that, when the credit in favor of Isabelo P. Lim was created as a result of the transfer to petitioner of real properties and cash, payment of interest was expressly stipulated in writing. As no interest shall be due unless it has been expressly stipulated in writing (Art. 1956, Civil Code of the Philippines), interest cannot be exacted by Isabelo P. Lim. Moreover, the same credit assigned to Doña Vicenta Vda. de Lim by her son cannot earn interest because the assignee cannot have a superior right than the assignor. Hence, the deduction from gross income of ₱20,000.00 as interest expense was properly denied by respondent.)

THIRD ISSUE:

Entertainment expense of ₱380.00.- Of the total sum of ₱1,419.00 claimed as entertainment expense, the amount of ₱380.00 was disallowed for the reason that said amount was a personal expense as it was spent for a party in honor of Vicenta Vda. de Lim, mother of Isabelo P. Lim, who is neither an officer nor a stockholder of petitioner corporation (pp. 90-91, t.s.n., Session of Sept. 1, 1966). However, it is claimed that said expense was incurred to furnish food and refreshment during the meetings of the members of the Board of Directors and for the friends of Isabelo P. Lim who had some business dealings with certain realtors or agents who offered to sell certain property to petitioner (p. 15, t.s.n., Aug. 29, 1966; p. 51, t.s.n., Sept. 1, 1966). This expense was made in lieu of per diems which the directors of petitioner did not receive (p. 15, t.s.n., Aug. 29, 1966). Finding that the disallowed item of ₱380.00 had some definite reasonable purpose connected with petitioner's business, we rule that its disallowance is not proper.

FOURTH ISSUE:

Christmas expense of ₱1,113.85.- This amount was disallowed by the revenue examiner because the recipients were not in any way connected with or had business dealings with petitioner. Petitioner contends that the expense represents payment for articles, such as sewing machines, shirts, pants, handkerchiefs, pajamas, Manila Rum, remnants, T-shirts, chains for keys, rice, boy's shirts, etc. (pp. 11-14, t.s.n., Aug. 29, 1966; Exhs. C, D & D-1), which were distributed as christmas presents to its office employees, field employees and field laborers (pp. 47, 52-54, t.s.n., Sept. 1, 1966), who were employed in the construction business of petitioner.

(Christmas presents for employees are allowed as a deduction from gross income (William H. Limerick, 50,144 PH Memo TC; Abe Wokomitz, 49,212 PH Memo TC; Miami Roofing & Sheet Metal, Inc., 47,091 Ph Memo TC; Evans-Winter-Hebb, Inc. 42,423 PH Memo TC; see also Popular Dry Goods v. Comm., 1949 PH TC Memo Par. 49,212). Amounts paid for gifts (hosiery) distributed to employees are allowable (Liberty Hosiery Mills v. Comm. of Int. Rev., 31 BTA 64, 70). The grant of said christmas gifts to petitioner's employees will surely enhance and increase their dedication and loyalty to petitioner's business. Moreover, in view of the moderate amount of christmas gifts involved in this case, we find no justifiable reason to disallow it.) In C.T.A. Case No. 1358 involving the same parties, decided on September 20, 1967, this Court disallowed the Christmas expenses of ₱13,703.75 because they were made solely for the purpose of creating good will and the gifts were given indiscriminately to employees and non-employees of petitioner.

FIFTH ISSUE:

Miscellaneous expenses of ₱523.90. - The amount of ₱523.90 was spent for subscriptions to the Chronicle, New York Times, Newsweek, and Manila Times and for uniforms of the elevator operator, chauffeur and clerk-messenger (p. 15, t.s.n., Session of Aug. 29, 1966; p. 52, t.s.n., Sept. 1, 1966). Respondent claims that the subscription expense for newspapers and periodical is a personal and not a business expense. (Suffice it to say that the cost of subscription to newspapers is not deductible unless it can be shown that the said newspapers were used solely or even principally for business purposes (Mertens, op. cit., Chap. 25, pp. 65-66, citing Robert J. Wallendal, 31 TC 1248). In the case at bar, in the absence of such showing, we are constrained to hold that the expense for subscription of newspapers is not deductible from gross income.)

The amounts paid for uniforms of the employees, which were considered by petitioner as bonuses, are allowable deduction from gross income because they represent additional compensation for services actually rendered by the recipients thereof (Walter P. Temple vs. Comm. of Int. Rev., 10 BTA 1238). (However, since the amounts spent for uniforms and subscriptions to newspapers and periodicals were not allocated, and there is no way of determining the allowable portion of the expense item of ₱523.90, we rule that the disallowed deduction of ₱523.90 is justified by the circumstance of the case.)

In view of the foregoing, the disallowed deduction from petitioner's gross income amounted to ₱22,723.90 computed as follows:

Bonus ----------------------	₱ 2,200.00
Interest expense ------------	20,000.00
Miscellaneous expense --------	523.00
Total disallowed deductions ---	₱22,723.90

Consequently, the amount of deficiency income tax for 1960, inclusive of 1/2% monthly interest thereon from April 15, 1961 to April 16, 1964, for which petitioner is liable, amounted to ₱7,240.48 computed as follows:

Net income per return -------------		₱ 91,554.88
Plus unallowable deductions:		
Bonus ---------------	₱ 2,200.00	
Interest expense ----	20,000.00	
Miscellaneous expense-	523.90	22,723.90
Adjusted net income subject to tax		₱114,278.78
Income tax due thereon ----------		₱ 26,284.00
Less amount already assessed & paid		20,148.00
Deficiency tax due -------------		₱ 6,136.00
Plus 1/2% mo. int. from 4/15/61 to 4/16/64 --------------------		1,104.48
Total deficiency tax ------------		₱ 7,240.48

WHEREFORE, the deficiency income tax assessment of ₱10,149.44 appealed from is hereby modified. Petitioner is hereby ordered to pay respondent deficiency income tax of ₱7,240.48 inclusive of 1/2% monthly interest thereon from April 15, 1961 to April 16, 1964. If the deficiency income 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 not exceed the amount corresponding to a period of three (3) years. Without pronouncement as to costs.

SO ORDERED

Quezon City, December 11, 1967.

Estanislao R. Alvarez
ESTANISLAO R. ALVAREZ
Associate Judge

WE CONCUR:

R. M. Umali
ROMAN M. UMALI
Presiding Judge

Ramon L. Avanceña
RAMON L. AVANCEÑA
Associate Judge