REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

HOME PRODUCTS INTERNATIONAL, LTD.,
Petitioner,

- versus -

C.T.A. CASE NO. 725

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

x - - - - - - - - - - - - - - - x

D E C I S I O N

This is an appeal from the decision of respondent Commissioner of Internal Revenue assessing against and demanding from petitioner Home Products International, Ltd. deficiency income taxes for the years 1955 and 1956 in the amounts of ₱1,940.00 and ₱2,164.00, respectively. (Par. 9, Partial Stipulation of Facts, hereinafter referred to as Stifacts, pp. 22-26, CTA rec.; Exh. 1, pp. 31-33, Folder No. 1, BIR rec.; Exh. 2, pp. 55-56, Folder No. 2, BIR rec.) These deficiency income tax assessments arose from the disallowance by the respondent of all the claims for deductions for business expenses and depreciation in petitioner's income tax returns for the years in question.

The petitioner, Home Products International, Ltd., is a nonresident foreign corporation not engaged in trade or business in the Philippines and duly organized and existing under the laws of the State of New York, U.S.A. (Par. 1, Stifacts.)

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During the years 1955 and 1956, the petitioner realized income from sources within the Philippines which consisted of royalties and rental payments received from Muller & Phipps (Manila) Ltd. The royalties were received by virtue of a manufacture and distribution agreement dated January 1, 1950, and entered into between Whitehall Pharmacal Company, with the petitioner administering the rights of the afore-named company under the contract, on the one hand, and Muller & Phipps (Manila) Ltd., on the other hand. (Exh. A-2, pp. 29-35, Folder No. 2, BIR rec.) The rental payments were received by virtue of a lease agreement dated January 1, 1950, and entered into between the petitioner and Muller & Phipps (Manila) Ltd. (Exhs. A & A-1, pp. 36-42, Folder No. 2, BIR rec.; Par. 2, Stifacts.)

The terms of the above mentioned contracts gave Muller & Phipps (Manila) Ltd., the exclusive right to manufacture and sell in the Philippines "Kolynos" dental cream, the same to be manufactured with the machineries and equipments brought into the country by the petitioner and in accordance with the formula belonging to Whitehall Pharmacal Company.

For taxable years 1955 and 1956, the petitioner duly filed its income tax returns, reporting therein only its Philippine income and expenses. (Par. 3, Stifacts.) In separate assessments, (See Exh. 1, pp. 31-33, Folder No. 1, BIR rec. and Exh. 2, pp. 55-56, Folder No. 2, BIR rec.) the respondent disallowed all the deductions claimed by the petitioner for alleged business expenses and depreciation, except the claim for losses for the year 1956 in the amount of ₱3,800.00 which was allowed pursuant to Section 30 (d)(3) of the National Internal Revenue Code. (Par. 5, Stifacts.)

The petitioner protested against the assessments. (Par. 6, Stifacts.) After due hearing held on May 19, 1959, before the Appellate Division of the Bureau of Internal Revenue, (Par. 7, Stifacts) the petitioner, on November 25, 1959, received the decision of the respondent finally demanding the payment of the amounts of ₱1,940.00 and ₱2,164.00, representing petitioner's alleged deficiency income tax liabilities for the years 1955 and 1956, respectively. (Par. 9, Stifacts.) Hence, the present appeal.

From the view that we take of the present case, and considering the pleadings of the parties, particularly the "Partial Stipulation of Facts", (pp. 22-26, CTA rec.) the only issue to be resolved in this case is whether or not the petitioner, a nonresident foreign corporation, not engaged in trade or business within the Philippines and not having any office or place of business therein, is entitled to deduct the expenses it incurred in the Philippines, and an allowance for depreciation, during the taxable years in question.

The petitioner claims that it is entitled to deduct the expenses incurred in the Philippines, related to its trade or business, and to an allowance for depreciation, and is subject to income tax based only on its net income. On the other hand, the respondent contends that the petitioner herein is not allowed deductions for business expenses under Section 30 (a)(2) of the Tax Code, nor to an allowance for depreciation, and is therefore subject to income tax based on its gross income. (Par. 10, Stifacts.)

At the outset, we would like to state that "the most important rule regarding the allowance of deductions in general is that they are a matter of legislative grace. Therefore, a taxpayer seeking a deduction must be able to point to an applicable statute and show that he comes within its terms." (Prentice-Hall, Federal Taxes, Vol. 2, par. 11,042, p. 11,027, 1962 Edition.)

In the case at bar, the pertinent and applicable provisions of the National Internal Revenue Code read as follows:

> "Sec. 30. Deductions from gross income. In computing net income there shall be allowed as deductions -
>
> "(a) Expenses:
>
> x x x x
>
> "(2) Expenses allowable to nonresident alien individuals and foreign corporations.- In the case of a nonresident alien individual or a foreign corporation, the expenses paid or incurred in carrying on any business or trade conducted within the Philippines exclusively.
>
> x x x x
>
> "(f) Depreciation:
>
> x x x x

> "(2) Depreciation deductible by nonresident aliens or foreign corporations.- In the case of a nonresident alien individual or a foreign corporation, a reasonable allowance for the deterioration of property arising out of its use or employment or its nonuse in the business or trade shall be permitted only when such property is located within the Philippines." (Underscoring supplied.)

It is clear from the above quoted provisions of the Tax Code that one of the requirements before business expenses can be allowed as a deduction from the gross income in computing the net income of a foreign corporation is that the expenses be paid or incurred in "carrying on any business or trade" within the Philippines. Likewise, before depreciation can be considered deductible by a foreign corporation, the deterioration of the property must arise out of "its use or employment or its nonuse in the business or trade," which means that the property must be "devoted to the trade or business" in which the taxpayer concerned is engaged in. (P. Dougherty Co., vs. Commissioner of Internal Revenue, 159 F. 2d. 269; 35 AFTR 669.)

In the instant case, the petitioner admits that it is "a nonresident foreign corporation not engaged in trade or business in the Philippines". (Par. 1, Sti-facts.) Accordingly, inasmuch as it was "not engaged in trade or business" in the Philippines during the years under review, the business expenses in question could not have been paid or incurred in "carrying on any business or trade" conducted within the Philippines, nor the property on which depreciation is being claimed as a deduction be considered as having been "devoted to the trade or business". We are therefore of the opinion and so hold that the respondent Commissioner of Internal Revenue properly disallowed the items for business expenses and depreciation as deduction from the gross income of the petitioner in computing its net income for the years 1955 and 1956, and his decision must be affirmed.

It is true as argued by the petitioner that prior to the enactment of Republic Act No. 2343 which took effect on June 20, 1959, Section 24 did "not make any distinction between domestic, resident foreign and nonresident foreign corporations in that they all are subject to the same rate of income tax and this tax is to be levied only upon their taxable net income". (pp. 5-6, Memorandum for Petitioner, pp. 33-43, CTA rec.; Underscoring supplied.) In other words, foreign corporations were also entitled to deductions from their gross income pursuant to the provisions of Section 30 of the National Internal Revenue Code. As a matter of fact, in the present case, the respondent authorized the deduction of ₱3,800.00 for losses sustained by the petitioner in the year 1956, and also expressed his willingness to allow another claim for deduction for interest if the petitioner did not only fail to "include in its income tax return all the information necessary for its calculation". (Exh. 2, pp. 55-56, Folder No. 2, BIR rec.)

But with regard to nonresident foreign corporations not engaged in trade or business in the Philippines, like the petitioner herein, they were likewise entitled to certain deductions authorized by the Tax Code, however, business expenses and depreciation are not among them as said deductions can be claimed by and granted only to those who are actually engaged in trade or business within the Philippines.

WHEREFORE, in view of the foregoing considerations, the decision appealed from is hereby affirmed, with costs against the petitioner.

SO ORDERED.

Manila, February 26, 1962.

AUGUSTO M. LUCIANO
Associate Judge

We concur:

MARIANO NABLE
Presiding Judge

ROMAN M. UMALI
Associate Judge