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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

STATES STEAMSHIP COMPANY,
Petitioner,

- versus - CTA CASE NO. 1401

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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7/16/75

D E C I S I O N

Petitioner has appealed from the decision of respondent Commissioner of Internal Revenue dated May 6, 1963, holding it liable for 1959 deficiency income tax amounting to ₱61,689.34, inclusive of interest.

Petitioner is a foreign shipping company which is duly authorized to do business in the Philippines. On July 1 and August 23, 1957, it merged and consolidated with two other U.S.A. corporations, namely: States Line Inc. and Pacific Transport Lines, Inc., thereby succeeding to and assuming all the rights, assets, liabilities, and obligations of the consolidated corporations.

On August 23, 1957, petitioner entered into an Operating-Differential Subsidy Agreement with the United States of America, represented by the Federal Maritime Board. (Exh. M-1, pp. 262-

326, 273, CTA rec.) The operating-differential subsidy ("Merchant Marine Act, 1936", Sections 601-603 (b), Exh. L, pp. 128-169, 159-160, CTA rec; Exh. M-1, op. cit.) is a yearly financial aid in the operations of vessels used to promote foreign commerce of the United States and to meet the foreign-flag ships' competition.

The said subsidy contract provides that it "shall not exceed the excess of the fair and reasonable cost of insurance, wages and subsistence of officers and crews, and any other items of expense in which the Commissioner (Federal Maritime Board), shall find and determine that the applicant is at a substantial disadvantage in competition with vessels of the foreign country hereinafter referred to, in the operation under United States registry of the vessel or vessels covered by the contract, over the estimated fair and reasonable cost of the same items of expense... if such vessel or vessels were operating under the registry of a foreign country whose vessels are substantial competitors of the vessel or vessels covered by the contract." (Sec. 603(b), Merchant Marine Act, 1936, Exh. L, at p. 160, CTA rec.; Exh. M-1, op. cit.)

On June 14, 1960, petitioner filed its 1959 income tax return and reported therein a net loss from Philippine operations of ₱169,083.84, computed as follows:

| | | |
|---|---|---|
| Gross receipts from cargo lifted at Philippine ports | | ₱4,150,861.74 |
| Gross receipts from world vessel operations | ₱45,200,819.34 | |
| Operating-Differential Subsidy | 10,792,344.00 | |
| Less: Interim provision for recapture | (1,174,184.00) | |
| Required deposits of earnings | (2,350,000.00) | |
| Total World Gross Receipts | ₱52,468,979.34 | |
| Ratio of Philippine Gross Receipts to World Gross Receipts | 7.911% | |
| Allocation of Vessel Operating Expense: | | |
| Vessel Operating Expense | 42,356,761.08 | |
| Vessel Depreciation | 3,371,301.74 | |
| Loss on Cargo Claims Resulting from sinking of S.S. Pennsylvania | 2,890,788.44 | |
| T o t a l | ₱48,618,851.26 | |

| | | | |
|---|---|---|---|
| Amount of Vessel Operating Expense Allocable to Philippine Operations (₱48,618,851.26 x 7.911%) | | | ₱3,846,237.32 |
| Allocation of Administrative Expenses and other Deductions from Income: | | | |
| Administrative Expenses | | ₱5,289,758.76 | |
| Interest Expense | | 573,951.64 | |
| Other (Income) and Expense | (₱1,673.98) | | |
| Less: Federal income tax adjustments | 68,913.44 - | | |
| Proceeds of Life Insurance | 50,000.00- | | |
| Capital Gains and Losses | 7,019.56- | 124,259.02 | |
| T o t a l | | ₱5,987,969.42 | |
| Amount of Administrative Expenses and Other Deductions from Income Allocable to Philippine Operations (₱5,987,969.42 x 7.911%) | | | 473,708.26 |
| Total Expenses Allocable to Philippine Operations | | | 4,319,945.58 |
| Net Loss from Philippine Operations: | | | ₱ 169,083.84 |

(Exh. B-1, p. 371 CTA rec.)

In the investigation conducted by Revenue Examiners Pio Natividad and Simeon Casingal of the 1959 income tax return of petitioner, they reported and recommended to respondent the recomputation of petitioner's Philippine income tax by including certain items to world gross income, such as agency fees, commissions, and other shipping income of $131,924 (₱263,848); interest income of $111,634 (₱223,268); and other net income of $837 (₱1,673.98); and the item of "Interim Provision for Recapture" amounting to $587,092 (₱1,174,184.00) was added to world expense, itemized as follows:

WORLD GROSS INCOME:

| | | |
|---|---|---|
| Revenue | $22,600,410 | (₱45,200,819.34) |
| Operating-Differential Subsidy | $ 5,396,172 | ( 10,792,344.00) |
| Agency Fees, Commissions, and Other Shipping Income | 131,924 | ( 263,848.00) |
| Interest Income | 111,634 | ( 223,268.00) |
| Other Income (net) | 837 | ( 1,673.98) |
| T o t a l | $28,240,977 x 2 | |
| | = | ₱56,481,954 |

WORLD EXPENSE:

| | | |
|---|---|---|
| Operating Expenses | 21,178,381 | (₱42,356,761.08) |
| Depreciation | 1,685,651 | ( 3,371,301.74) |
| Interim Provision for Recapture | 587,092 | ( 1,174,184.00) |
| Administrative & General Expenses | 2,644,879 | ( 5,289,758.76) |
| Interest (Expenses) | 286,975 | ( 573,951.84) |
| T o t a l | $ 26,382,978 x 2 | |
| | | ₱52,765,956.00 |

Net World Income $ 1,857,999 ( 3,715,998.00)

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For Philippine Income Tax Purposes

Gross receipts from cargo lifted at Philippine Ports ₱ 4,150,861.74

Less: P.I. Expenses:

$\frac{\text{P.I. Gross Income x World's Expenses}}{\text{World's Gross Income}}$, or

$\frac{₱4,150,861.74 \times ₱52,765,956.00}{₱56,481,954.00}$

| | |
|---|---|
| 7.349% x ₱52,765.00 | ₱ 3,877,770.11 |
| Philippine Net Income | ₱ 273,091.63 |

Philippine Income Tax due thereon ₱ 73,927.00

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Based upon the report and recommendation of Revenue Examiners Natividad and Casingal, respondent had also disallowed the item "Required Deposits of Earnings" in the sum of ₱2,350,000.00 as exclusion from petitioner's gross income, and also disallowed as part of petitioner's world expense subject to allocation and claimed in its income tax return, the following items:

| | |
|---|---|
| (1) Loss on Cargo claims resulting the sinking of S.S. Pensylvannia | ₱ 2,870,788.44 |
| (2) Federal income tax adjustment | 68,913.44 |
| (3) Proceeds of Life Insurance | 50,000.00 |
| (4) Capital gains & losses | 7,019.56 |

(Exhs. 2 & 3, pp. 14 & 17, respectively, BIR rec.)

The foregoing data were taken by respondent's examiners from the Statement of Income and Earned surplus certified by Haskins & Sells, petitioner's U.S. accountants. (Exh. R, pp. 6-12, BIR rec.)

The recomputation of the tax by respondent resulted in an increase in petitioner's world gross income to ₱56,481,954 as against ₱52,468,979.34 returned by petitioner; and a decrease in the world expense from ₱54,606,820.68 (₱48,618,851.26 plus ₱5,987,969.42) to ₱52,765,956. Consequently, by respondent's computation, the ratio of petitioner's income to gross world income decreased from 7.911% to only 7.349% as well as the allocable expense for Philippine operation from ₱4,319,945.58 to ₱3,877,770.15, thereby finding a net taxable income of ₱273,091.63, for which petitioner was assessed a deficiency income tax due of ₱73,927.00, *infra*.

The (1) agency fees, commissions and other shipping income of ₱263,848; (2) interest income of ₱223,268; and (3) other net income of ₱1,673.98 were added by the revenue examiners to the world gross income of petitioner because said items were considered by them as income incident to the shipping business.

The same examiners included in petitioner's gross income the "Required Deposits of Earnings" of ₱2,350,000.00 because said amount was not required to be deposited under the Operating-Differential Subsidy agreement. It would appear, therefore, that said deposit was made voluntarily by petitioner without the blessing and approval of the Federal Maritime Board.

With respect to the item of loss on cargo claims amounting to ₱2,890,788.44 as a result of the sinking of the vessel SS. Pennsylvannia, then owned by the absorbed Pacific Transport Lines, Inc., respondent's examiners disallowed the same as part of petitioner's world expense since they considered that the loss occurred in 1952; and that the loss, for purposes of U.S. Income Tax, was charged to capital surplus and, therefore, not an expense. However, for Philippine Income Tax purposes, said loss had been charged by petitioner to operations. Finally, the items of Federal income tax adjustment, proceeds of life insurance, and the capital gains and losses of ₱68,913.44, ₱50,000 and ₱7,019.56, respectively, or a total of ₱125,933.00, were disallowed as deductible expenses because said items were not taken up in the Statement of Income and Earned Surplus prepared by Haskins & Sells, petitioner's U.S. accountants. They were, however, taken up in the Statement of Income (Philippine Operations) as prepared by the accounting firm of Sycip, Gorres, Velayo & Co. (Exh. 3, p. 17, BIR rec.)

Consequently, on January 19, 1962, respondent issued against petitioner the 1959 deficiency income tax assessment amounting to ₱81,689.34, computed as follows:

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| | |
|---|---|
| Net loss per return .......... | ( ₱169,083.84) |
| Net income per report of investigation ........ | ₱273,091.63 |
| Tax due thereon ....... | ₱ 73,927.00 |
| Add: 1/2% monthly interest from 4-19-60 to 1-19-62 ... | 7,762.34 |
| TOTAL AMOUNT DUE AND COLLECTIBLE | ₱81,689.34 |

The issues submitted for resolution of this Court are the following:

1) Whether or not the inclusion by respondent of the agency fees, commissions and other shipping income amounting to ₱263,848.00, interest income of ₱223,268.00, and other income (net) of ₱1,674.00, or a total of ₱488,790.00, to petitioner's

world gross income is valid and justified;

2) Whether or not the disallowance from petitioner's expenses of the loss on cargo claims amounting to ₱2,890,788.44 as a result of the sinking of the S.S. Pennsylvania is valid and justified;

3) Whether or not the disallowance from petitioner's expenses of the deductions consisting of federal income tax adjustment, proceeds of life insurance and capital gains and losses amounting to ₱125,933.00 is valid and justified;

4) Whether or not respondent's treatment of the interim provision for recapture in the amount of ₱1,174,184.00 as part of petitioner's world gross expense, instead of an exclusion from gross income, is valid and justified; and

5) Whether or not respondent's inclusion of ₱2,350,000.00, which was deposited in the Bank of America, in petitioner's world gross income is valid and justified.

Petitioner contends that the agency fees, commissions, and other shipping income amounting to ₱263,848.00, the interest income of ₱223,268.00, and the other income (net) of ₱1,674.00, or a total of ₱488,790.00, do not form part of its world income because they were derived in full from sources outside the Philippines and should, therefore, be excluded from petitioner's "World Gross Income" under Section 163 of the Income Tax Regulations.

Respondent, however, included the agency fees, commissions and other shipping income, interest income and the other income in petitioner's world gross income because they are considered income incident to the shipping business and should therefore form part of its world gross income (p. 35, t.s.n., March 19, 1973) for purposes of computing its 1959 taxable net income from Philippine sources under the formula of general apportionment provided in Section 163 of the same Income Tax Regulations.

*ncpy* Section 37 of the National Internal Revenue Code classified income of foreign corporations into three categories, to wit: (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 foreign corporations, like petitioner herein, are taxable only on income from sources within the Philippines, whether derived exclusively from sources within the Philippines or partly from sources within and partly from sources without the Philippines provided they are allocable to sources within the Philippines. (Dai-ichi Chuo Kisen Kaisha v. Com. of Internal Revenue, CTACase No. 1277, May 31, 1969; U.S. Lines Company v. Commissioner of Internal Revenue, CTA Case N o. 1305, June 28, 1973; Ginn and Company v. Commissioner of Internal Revenue, CTA Case No. 674, May 21, 1962; Holland East Asia Lines v. Coll. of Int. Rev., CTA Case N o. 383, August 5, 1958.) Needless to say, income of petitioner derived in full from sources outside the Philippines is not, therefore, subject to the Philippine income tax, pursuant to Section 37 (c) of the Tax Code which provides as follows:

> SEC. 37. Income From Sources Within the Philippines.-
>
> x x x x x x x x x
>
> (c) Gross Income From Sources Without the Philippines.- The following items of gross income shall be treated as income from sources without the Philippines:

> (1) Interest other than that derived from sources within the Philippines as provided in paragraph (2) of subsection (a) of this section;
>
> (2) Dividends other than those derived from sources within the Philippines as provided in paragraph (2) of subsection (a) of this section;
>
> (3) Compensation for labor or personal services performed without the Philippines;
>
> (4) Rentals or royalties from property located without the Philippines or from any interest in such property, including rentals or royalties for the use of or for the privilege of using without the Philippines, patents, copyrights, secret processes and formulas, goodwill, trademarks, trade brands, franchises, and other like properties; and
>
> (5) Gains, profits, and income from the sale of real property located without the Philippines."
>
> (See also Section 158 of Income Tax or Revenue Regulations No. 2).

Petitioner received the agency fees, commissions and other shipping income from agency services for other steamship lines in its several offices in the United States (Exh. P. at p. 95, CTA rec.); the interest income was earned from Government securities and time deposits in the United States; and the other net income was realized from the gains on sales of fixed assets in the United States (Ibid., p. 94.) CTA rec.; see also

Exh. 1, pp. 384-385, CTA rec.); the proceeds of insurance taken on the life of Eric Wroldsen and refund of Federal Income tax were derived in full from sources outside the Philippines. (Ibid, p. 95, CTA rec.; ibid, pp. 384-385, CTA rec.).

Under the provisions of Section 37 of the Tax Code, as implemented by Section 158 of the Income Tax Regulations, the income mentioned above should not be included in the gross income of petitioner for the purpose of determining its Philippine income under Section 163 of the Income Tax Regulations because, if an item of income emanated actually from sources within or without the Philippine under the provisions of Section 37(a) and (c) of the Tax Code, then Section 37(e) and Section 163 of the Income Tax Regulations abovementioned will no longer apply (United States Lines v. Commissioner of Internal Revenue., supra.) as the said income are not subject to allocation or apportionment to sources within or without the Philippines.

Thus, in the case of United States Lines v. Commissioner of Internal Revenue, supra, citing Daiichi Chuo Kisen Kaisha v. Commissioner of Internal Revenue, supra, this Court ruled as follows:

> " x x x 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 Martens' 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."

SECOND ISSUE:

Respondent disallowed from petitioners expenses the loss on cargo claims resulting from the sinking of the S.S. Pensylvania on the theory that the loss occurred in 1952 and for Federal Income Tax purposes the loss had been charged to capital surplus. However, for Philippine income tax purposes the same loss had been charged to operations. (Exh. 3, p. 17, BIR rec.) Respondent further argues that inasmuch as the loss on cargo claims had been filed in 1952 by the cargo owners, it is presumed that the owner of the vessel, the Pacific Transport Lines, Inc., had already claimed this loss in its income tax return; and that after Pacific Transport Lines Inc. and petitioner had been merged, the latter can no longer claim the same loss in 1959 for that would result in claiming a loss by two different entities. And finally, it is claimed that the loss which occurred in 1952 cannot be deducted for income tax purposes in 1959. (pp. 31-32, t.s.n., March 19, 1973.)

Petitioner, however, insists that the shipper's claims for losses were still pending in courts and, therefore, the loss remained unliquidated and undetermined, both as to the exact amount recoverable by claimants and as to whether such loss is to be compensated "by insurance or otherwise." In brief, petitioner's losses arising from claims for lost cargo were not yet closed and completed.

We sustain the view of petitioner. There are four requisites in the deductibility of a loss, to wit: (1) there must be an actual loss; (2) the loss must be one sustained by the taxpayer; (3) the loss must be one sustained in a closed and completed transaction during the taxable year; and (4) the loss must not be compensated for by insurance or otherwise. (Mertens, Law of Federal Income Taxation, Vol. 5, 1956 Ed., Sec. 28.04, Chap. 28, p. 9.) Generally, the deductible loss from gross income must be one sustained by the taxpayer. However, in case of merger where a corporation assumed the obligation of its components by operation of law, the obligation which it assumed and paid is a deductible expense and considered as a loss. (Western Maryland Ry. Co. vs. Comm. of Int. Rev., 33 F (2d) 695,698.)

In the case at bar, the S.S. Pensylvania of the Pacific Transport Lines, Inc., sank in 1952. The payment of the claims of the different cargo owners on May 15, 1959 by petitioner, which succeeded to the obligations of the former Pacific Transport Lines, Inc., was based on the decision of the United States Supreme Court dated February 24, 1959. (Deposition, pp. 90-91, CTA rec.) It was on the basis of the said decision of the same Court in 1959, that liability of petitioner became fixed and ascertained. Consequently, the losses arising from the claims of the different cargo owners were deductible only in 1959. (Section 95, Income Tax Regulations).

Third Issue:

Respondent disallowed the following deductions of petitioner, namely: federal income tax adjustment amounting to ₱68,913.44; the proceeds of life insurance of ₱50,000.00; and the capital gains and losses of ₱7,019.56, or a total of ₱125,933.00, as part of its world gross expense because they were not taken up in the world income statements of petitioner in 1959. (Exh. 1, pp. 384-385, CTA rec.) However, after consultation with its head office abroad petitioner admitted that these items were not being claimed as part of petitioner's world expenses for the purposes of Philippine income tax liability for 1959 under Section 163 of the income tax regulations. Consequently, the correctness of the disallowance of the said items as deductions from gross expense is admitted by petitioner.

FOURTH ISSUE:

The treatment by respondent of the interim provisions for recapture amounting to P1,174,184.00 as part of petitioner's world expense, instead of a deduction from petitioner's gross income is not valid and justified.

The said provision for recapture is the amount which under the operating-differential subsidy agreement, the United States Government, thru the Federal Maritime Board, determines after a 10 year recapture period which is equal to one-half of of petitioner's annual profits, in excess of 10 per centum of its subsidized operation, which shall in no case be in excess of the operating-differential subsidy payments made to petitioner. (Exh. M-1, pp. 318-319, CTA rec.) Accordingly, petitioner had in this case provided for the sum of P1,174,184.00 for recapture of excess profits.

We maintain that the amount of operating-differential subsidy received by petitioner from the Federal Government under the operating-differential subsidy agreement is reduced by the amount of recaptured profits. The operating-differential subsidy is, therefore, income only to the extent that has been actually received after having deducted the amount of recaptured excess profits. Consequently, only the net operating differential subsidy received by petitioner should be considered gross income, and the interim provision for recapture should be properly considered as an exclusion from, or a reduction to gross income, and should not form part of gross expense as determined by respondent.

For instance, if "gross sales" is equated with operating-differential subsidy payments, and "returned sales" with the interim provision for recapture, whether for tax or for accounting purposes, it would be an error to treat the returned sales as an expense instead of exclusion from the gross sales.

FIFTH ISSUE:

The disallowance of the required deposit of earnings amounting to P2,350,000.00 as a deduction from gross income is not valid and justified. Respondent disallowed this item for the reason that it is not allegedly a requirement in the operating-differential subsidy agreement, but only a mere voluntary intention on the part of petitioner to make said deposit, subject to the approval of the Maritime Administration (Federal Maritime Board) [p. 17, BIR rec.] At the hearing, Revenue Examiner Natividad testified that this item was disallowed because the same was not included in petitioner's financial statement and that it was more in a position to know whether this amount was allowed or approved by the Federal Maritime Board. (pp. 29-30, t.s.n., March 19, 1973).

In brief, respondent disallowed the deduction of the said deposit from petitioner's gross income because it was a mere voluntary intention on the part of petitioner to make such deposit, subject to the approval of the Federal Maritime Board. Moreover, the said deposit has not been reflected in the financial statement submitted by petitioner's U.S. accountants. Consequently, respondent presumed that the deposit in question was not approved by the Federal Maritime Board.

Under the Merchant Marine Act of 1936, every contract for an operating-differential subsidy required the party-company to make certain deposits in statutory reserve funds under the joint control of said company-operator and the U.S. Government. (Exh. M-1, p. 311, CTA rec.) Such deposits consist principally of amounts equal to the depreciation charges on subsidized vessels (if earned), and earnings in excess of 10% of capital necessarily employed, less the amount of subsidy which is held by the Maritime Administration to satisfy recapture requirements. (Art. II-25(a), (3), Merchant Marine Act, 1936, Exh. M-1, p. 311, CTA re c.; Exh. L-1, p. 162, CTA rec.) These mandatory deposits or funds (Exh. N, p. 327, CTA rec.) were to be used for the purpose of replacement, reconditioning of vessels, and with the approval of the Federal Maritime Board, for the operator's general corporate purposes. (Exh. M-1, op. cit.)

The earnings deposited or required to be deposited in reserve funds are not subject to U.S. Federal income tax until withdrawn for general purposes, or upon termination of the subsidized operation. (Exh. L-1, Sec 607 (h), p. 165, CTA rec.) Under this Act, specifically Section 607 (g), the approval of the Commission is a condition precedent to the deposit. Petitioner deposited the said earnings with the Bank of America in a joint account with the U.S. Government with the latter's approval. (Exh. L, L-1, M-1, pp. 128, 161-162 and 262, respectively, CTA rec.)

Under the terms of the statutory agreement, the disallowance by respondent of the deduction of deposit from petitioner's gross income is unjustified. The said deposit is a mandatory statutory requirement. (Exh. N, op. cit.). Under the operating-differential subsidy agreement, the deposit of earnings should be excluded from gross income, or specifically from the operating-differential subsidy income, in order to reflect the true and correct gross income of petitioner. The said deposits of earnings were intended to prevent their use, benefit and disposal. Consequently, it cannot be said that the amount deposited with the bank is income to the taxpayer under "the claim of right theory" because the rule contemplates the receipt of income without restriction as to its use or disposition. (See North American Oil Consolidated vs. Burnet, 11 AFTR 16,18.) This is so because the funds deposited can be considered income only during the year in which they were withdrawn. (Exh. L-1, Sec 607 (h), Merchant Marine Act, 1936, p. 165 CTA rec.)

In fact, because of the restricted nature of the funds deposited, the United States Congress has seen fit to exempt said deposits from all federal taxes. (Section 607 (h), Merchant Marine Act of 1936, Exh. L-1, p. 165, CTA rec.; Exh. M-1, p. 311, CTA rec.) In brief, the earnings deposited in bank should be treated as "deferred income" but they do not constitute part of petitioner's world gross income in 1959.

We find, therefore, that petitioner had a total world gross income of ₱52,468,980.00, a world expense of ₱52,796,909.44, and a gross income of ₱4,150,861.74 from Philippine sources.

Petitioner's operation in the Philippines resulted in a net loss of ₱25,373.79 in 1959, computed as follows:

World Gross Income

| | |
|---|---|
| Revenue | ₱45,200,820.00 |
| Operating-Differential subsidy | 10,792,344.00 |
| Less: | |
| Interim Provision for Recapture | ( 1,174,184.00) |
| Required Deposit of Earnings | ( 2,350,000.00) |
| | ₱ 52,468,980.00 |

World Expenses

| | |
|---|---|
| Vessel Operating Expenses | 42,356,762.00 |
| Depreciation | 1,685,651.00 |

| | |
|---|---|
| Loss on cargo claims resulting from sinking of S.S. Pennylvania | 2,890,788.44 |
| Administration & General Expenses | 573,950.00 |
| | ₱52,796,909.44 |

For Philippine Income Tax

| | |
|---|---|
| Gross receipts from cargo lifted at Philippine ports | 4,150,861.74 |

Less:

$\frac{\text{P.I. Gross Income}}{\text{World's Gross Income}}$ x World's Expenses or

$\frac{₱4,150,861.74}{₱52,468,980.00}$ x ₱ 52,796,909.44

7.91% x ₱52,796,909.44 ₱4,176,235.53

Net Loss from Philippine Operation (₱ 25,373.79)

WHEREFORE, the decision of the respondent Commissioner of Internal Revenue appealed from is hereby reversed and the disputed deficiency income tax assessment issued by said respondent against petitioner is hereby cancelled and nullified. Without costs.

SO ORDERED.

Quezon City, July 16, 1975.

ESTANISLAO R. ALVAREZ
Associate Judge

WE CONCUR:

ROMAN M. UMALI
Presiding Judge

RAMON L. AVANCEÑA
Associate Judge