Republic of the Philippines
COURT OF TAX APPEALS
Manila

ALHAMBRA CIGAR & CIGARETTE
MANUFACTURING COMPANY,
Petitioner,

- versus -

C.T.A. CASES NOS. 950
and 987

THE COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

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

D E C I S I O N

The petitioner has appealed from the decisions of the respondent holding it liable for the payment of deficiency income tax for the years 1954, 1955, 1956 and 1957. C.T.A. No. 950 is the appeal from the deficiency assessment for the year 1954 involving the sum of ₱24,603.00, while C.T.A. No. 987 is the appeal from the deficiency assessment for the years 1955, 1956 and 1957 involving the sums of ₱24,823.40, ₱24,892.98 and ₱24,014.34, respectively. As the two cases involve the same parties and the same issues, they were heard jointly.

The deficiency income tax assessment for each of the years under review was brought about by the disallowance by respondent of a portion of the salaries and bonuses of petitioner's non-resident President and Vice-President, and the total disallowance of their alleged commissions and directors' fees and certain expenses paid out of the discretionary fund of its resident Treasurer and Assistant Manager. For ready reference, the deficiency assessment for each of the years involved showing the items disallowed by respondent is itemized

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below:

1954

Net income per return ----------------		₱ 757,938.66
Deductions disallowed by respondent:		
1. Salaries-Officers (part) ----------	₱ 18,000.00	
2. Bonus-Officers (part) ----------	17,800.00	
3. Commission to Managers --------	27,215.22	
4. Directors' fees ---	23,009.42	
5. General expenses (discretionary fund) ---------	1,840.00	87,864.64
Net income per respondent		₱ 845,803.00
Tax due thereon ---------		228,826.00
Less: Amount assessed and paid ------------		204,223.00
Deficiency tax ----------		₱ 24,603.00

1955

Net income per return -----------------		₱ 755,956.32
Deductions disallowed by respondent:		
1. Salaries-Officers (part) ----------	₱ 18,000.00	
2. Bonus-Officers (part) ----------	15,500.00	
3. Commission to Managers --------	28,195.24	
4. Directors' fees ---	21,386.04	
5. General expenses (discretionary fund) --------	300.00	83,381.28
Net income per respondent-		₱ 839,338.00
Tax due thereon ---------		227,015.00
Less: Amount assessed and paid -------		203,668.00
Deficiency tax ----------		₱ 23,347.00
½% monthly interest from 6/20/59-7/11/60 --------		1,476.40
Total deficiency income tax and interest ------		₱ 24,823.40

1956

Net income per return ----------------		₱ 766,837.04
Deductions disallowed by respondent:		
1. Salaries-Officers (part) -----------	₱ 18,000.00	
2. Bonus-Officers (part) -----------	18,500.00	
3. Commissions to Managers ---------	26,361.74	
4. Directors' fees ----	20,720.46	83,582.20

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Net income per respondent-		₱ 850,419.00
Tax due thereon ---------		230,117.00
Less: Amount assessed and paid ---------		206,714.00
Deficiency tax ----------		₱ 23,403.00
½% interest from 6/20/59-7/11/60 --------------		1,489.98
Total deficiency tax and interest --------------		₱ 24,892.98

1957

Net income per return -----------------		₱ 885,857.57
Deductions disallowed by respondent:		
1. Salaries-Officers (part) ----------	₱18,000.00	
2. Bonus-Officers (part) ----------	16,500.00	
3. Commissions to Managers --------	26,288.58	
4. Directors' fees ---	19,433.26	
5. General expenses (discretionary fund)	409.40	80,631.24
Net income per respondent		₱ 966,489.00
Tax due thereon ---------		262,417.00
Less: Amount assessed and paid -------------		240,040.00
Deficiency tax ----------		₱ 22,577.00
½% interest from 6/20/59-7/11/60 --------------		1,437.34
Total deficiency income tax and interest -----		₱ 24,014.34

Of the five items shown above as having been disallowed by respondent, petitioner has abandoned its claim with respect to the general expenses paid out of the discretionary fund of its resident Manager. The sole issue, therefore, relates to the legality of the disallowance of part of the salaries and bonuses of petitioner's non-resident President and Vice-President, and the disallowance of the entire commissions and directors' fees paid to them as indicated above. Below is a tabulated statement of the items and the corresponding amounts disallowed for each of the years under review:

1954

		Allowed	Disallowed
1. Salary -			
(a) A.P. Kuenzle	₱15,000.00	₱ 6,000.00	₱ 9,000.00

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(b) H.A. Streiff	₱ 15,000.00	₱ 6,000.00	₱ 9,000.00
2. Bonus -			
(a) A.P. Kuenzle	14,750.00	5,850.00	8,900.00
(b) H.A. Streiff	14,750.00	5,850.00	8,900.00
3. Commissions -			
(a) A.P. Kuenzle	13,607.61	-- -- --	13,607.61
(b) H.A. Streiff	13,607.61	-- -- --	13,607.61
4. Directors' fees -			
(a) A.P. Kuenzle	11,504.71	-- -- --	11,504.71
(b) H.A. Streiff	11,504.71	-- -- --	11,504.71
Totals --	₱109,724.64	₱23,700.00	₱86,024.64

1955

1. Salary -			
(a) A.P. Kuenzle	₱ 15,000.00	₱ 6,000.00	₱ 9,000.00
(b) H.A. Streiff	15,000.00	6,000.00	9,000.00
2. Bonus -			
(a) A.P. Kuenzle	14,750.00	7,000.00	7,750.00
(b) H.A. Streiff	14,750.00	7,000.00	7,750.00
3. Commissions -			
(a) A.P. Kuenzle	14,097.62	-- -- --	14,097.62
(b) H.A. Streiff	14,097.62	-- -- --	14,097.62
4. Directors' fees -			
(a) A.P. Kuenzle	10,693.02	-- -- --	10,693.02
(b) H.A. Streiff	10,693.02	-- -- --	10,693.02
Totals --	₱109,081.28	₱26,000.00	₱83,081.28

1956

1. Salary -			
(a) A.P. Kuenzle	₱ 15,000.00	₱ 6,000.00	₱ 9,000.00
(b) H.A. Streiff	15,000.00	6,000.00	9,000.00
2. Bonus -			
(a) A.P. Kuenzle	14,750.00	5,500.00	9,250.00
(b) H.A. Streiff	14,750.00	5,500.00	9,250.00
3. Commissions -			
(a) A.P. Kuenzle	13,180.87	-- -- --	13,180.87
(b) H.A. Streiff	13,180.87	-- -- --	13,180.87
4. Directors' fees -			
(a) A.P. Kuenzle	10,360.23	-- -- --	10,360.23
(b) H.A. Streiff	10,360.23	-- -- --	10,360.23
Totals --	₱106,582.20	₱23,000.00	₱83,582.20

1957

1. Salary -			
(a) A.P. Kuenzle	₱ 15,000.00	₱ 6,000.00	₱ 9,000.00
(b) H.A. Streiff	15,000.00	6,000.00	9,000.00
2. Bonus -			
(a) A.P. Kuenzle	14,750.00	6,500.00	8,250.00
(b) H.A. Streiff	14,750.00	6,500.00	8,250.00
3. Commissions -			
(a) A.P. Kuenzle	13,144.29	-- -- --	13,144.29
(b) H.A. Streiff	13,144.29	-- -- --	13,144.29

4. Directors' fees -			
(a) A.P. Kuenzle	9,716.63	-- -- --	9,716.63
(b) H.A. Streiff	9,716.63	-- -- --	9,716.63
Totals ----	₱105,221.84	₱25,000.00	₱80,221.84

The evidence shows that prior to 1954, Messrs. A. P. Kuenzle and H.A. Streiff, President and Vice-President, respectively, of petitioner corporation, were each paid an annual salary of ₱6,000.00 and a bonus of about four times as much as the annual salary. In Alhambra Cigar and Cigarette Manufacturing Company v. Coll. of Int. Rev., C.T.A. No. 143, January 31, 1957 (affd. in G.R. Nos. L-12026 & L-12131, May 29, 1959), this Court held that considering the nature of the services performed by Messrs. Kuenzle and Streiff, the salary of ₱6,000.00 paid to each of them was reasonable and, therefore, deductible as ordinary and necessary business expense. The bonus paid to each of said officers was however reduced to the amount equivalent to that paid to Mr. W. Eggmann, the resident Treasurer and Manager of petitioner. Following the decision of the Supreme Court in G.R. Nos. L-12026 & L-12131, supra, respondent allowed as deduction ₱6,000.00 as salary to Messrs. Kuenzle and Streiff and a bonus equivalent to that paid annually to Mr. Eggmann from 1954 to 1957, as indicated above. In disallowing a portion of the salary and bonus paid to said officers, respondent stated:

> In disallowing ₱9,000.00 each from the salaries (₱15,000.00) received by Messrs. A.P. Kuenzle and H. A. Streiff for the year 1954, this Office merely followed the Supreme Court decision in the case entitled "Alhambra Cigar & Cigarette Manufacturing Company v. Collector of Internal Revenue", G. R. Nos. L-12026 and L-12131, involving a similar issue for the years 1949 to 1953 in which the

> High Tribunal allowed as salary only the sum of ₱6,000.00 for the aforementioned officers. The increase in salary of these two (2) officials from ₱6,000.00 to ₱15,000.00 for 1954 is not justified.
>
> It was verified by examiners of this Office that there was no increase of responsibility or of services rendered in the year 1954 to warrant the additional compensation. In the investigation, it was definitely ascertained from a responsible officer of your client that the increase in salary of ₱9,000.00 was a mere shift from the bonuses account to the salaries account for 1954 purposely to avoid the danger of being disallowed by this Office pursuant to Supreme Court ruling above-cited.
>
> The bonus allowed to Mr. W. Eggmann, treasurer and acting manager of the company for the year 1954 in the sum of ₱5,850.00 was used as a pattern for the bonuses allowed to Messrs. Kuenzle and Streiff for the year in question. When Mr. F. Koller, a responsible officer of your client was interviewed by our examiners regarding the adjustments of bonus given to these two officials, he could not give any reason for the decrease of the bonus of Mr. Eggmann except that the increase in salary and decrease of bonus of the latter official was purposely made so that the reasonableness of the bonus payments could not later on be questioned by this Office. Accordingly, based on the aforecited decision of the Supreme Court, the bonus allowed to Messrs. Kuenzle and Streiff should only be ₱5,850.00 each, which is the same as the bonus allowed to Mr. W. Eggmann. (Exh. 15, pp. 49-50, BIR records, C.T.A. No. 950.)

Upon the evidence of record, we find no justification to reverse or modify the decision of respondent with respect to the disallowance of a portion of the salaries and bonuses paid to Messrs. Kuenzle and Streiff. Petitioner seeks to justify the increase in the salaries of Messers. Kuenzle and Streiff on the ground of increased cost of living. The said officers of petitioner are, however, non-residents of the Philippines.

In connection with the commissions paid to Messrs.

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Kuenzle and Streiff, there is no evidence of any particular service rendered by them to petitioner to warrant payment of commissions. Counsel for petitioner sought to prove the various types of services performed by said officers, but the services mentioned are those for which they have been more than adequately compensated in the form of salaries and bonuses. As regards the directors' fees, it is admitted that Messrs. Kuenzle and Streiff "usually came to the Philippines every two years, and generally stayed from five to eight weeks." (Page 17, Memorandum for Petitioner.) We cannot see any justification for the payment of director's fees of about ₱10,000.00 to each of said officers for coming to the Philippines to visit their corporation once in two years. Being non-resident President and Vice-President of petitioner corporation of which they are the controlling stockholders, we are more inclined to believe that said commissions and directors' fees, payment of which was based on a certain percentage of the annual profits of petitioner, are in the nature of dividend distributions.

Finding no error in the decisions appealed from, the same are hereby affirmed, with costs against petitioner.

SO ORDERED.

Manila, May 30, 1964.

ROMAN M. UMALI
Associate Judge

WE CONCUR:

MARIANO NABLE
Presiding Judge

AUGUSTO M. LUCIANO
Associate Judge