REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

THE PHILIPPINE AMERICAN
LIFE INSURANCE COMPANY ,
Petitioner,

-versus- C.T.A. CASE No. 1689

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.
x- - - - - - - - - - - - - - -x

11/12/73

D E C I S I O N

This is an appeal from a decision of respondent Commissioner of Internal Revenue dated July 16, 1965, holding petitioner liable for the sums of ₱5,199.44, ₱115,743.66 and ₱50,262.00, as deficiency income tax for 1956, deficiency premium tax for 1953 to 1956, and deficiency withholding tax for 1954 to 1956, respectively, or a total of ₱171,205.00.

Petitioner is a domestic corporation engaged in the business of life insurance. In 1952, respondent disallowed petitioner's claim for "architect's fees." These were subsequently allowed but to be amortized for a period of five years from 1952 to 1956, and petitioner's claim for refund or tax credit filed therefor triggered off an investigation of its tax liabilities for 1953 to 1956. Respondent, in a letter dated March 3, 1960, assessed petitioner the sums of ₱158,430.00, ₱115,743.66 and ₱50,262.00, as deficiency income tax for 1955, deficiency premium tax for 1953 to 1956, and deficiency withholding tax for 1954 to 1956, respectively, or a total of ₱324,435.66.

On May 20, 1960, petitioner, through its external auditors, Sycip, Gorres, Velayo & Co., wrote respondent a letter requesting a reconsideration or withdrawal of his assessment. As a condition for the grant of said request, respondent required petitioner to execute a waiver of the statute of limitations which it accomplished on December 18, 1964. After several conferences with petitioner, respondent finally sent his letter-decision dated July 16, 1965, modifying his original assessment, the relevant portions of which are as follows:

1 9 5 6

Net income per return		₱1,412,898.85
Add: Unallowable deductions:		
(1) Fiscal agents fees	₱10,000.00	
(2) Premium income included in payments made by tenants in the housing projects which was credited to deposits of tenants	42,896.79	
(3) 20% amortization of architects fees (disallowed in 1952)	(37,159.76)	15,737.03
Net income per final investigation		₱1,428,635.88
Tax due thereon		₱ 392,018.00
Less: Tax already assessed		387,612.00
B a l a n c e		₱ 4,406.00
Add: ½% monthly interest from 6-20-59 to 6-20-62		793.44
TOTAL AMOUNT DUE & COLLECTIBLE		₱ 5,199.44

Premium taxes - 1953 to 1956 -

With respect to the deficiency premium taxes due from your client for the years 1953 to 1956, this Office is still of the opinion that the so-called dividends distributed to participating policyholders during the aforesaid years and the payments made by the company's housing project tenants corresponding to the premiums on insurance taken by them are subject to the premium tax.

This Office, therefore, reiterates the demand for the collection of the total amount of ₱115,743.66 representing deficiency premium tax for the years 1953 to 1956.

Withholding Tax - 1954 to 1956 -

This Office is reiterating its withholding tax assessment for the years 1954 to 1956, it appearing that the said branch managers are in truth and in fact employees of your client and you, as withholding agent, should have withheld the corresponding withholding tax on over-riding commission in accordance with Article 2 of Supplement A of the National Internal Revenue Code.

It is, therefore, requested that you urge your client to pay the aforesaid amounts of ₱115,743.66, ₱50,262.00 and ₱5,199.44 representing premium, withholding and income taxes, respectively, to our Collection Agent in the Office of our Regional Director, Regional Office No. 5, BIR, Soriano Building, Claro M. Recto Ave., Manila, on or before August 16, 1965.

Still dissatisfied with the aforesaid action taken by respondent, petitioner interposed the present appeal on September 14, 1965. In its petition for review, petitioner included the refund of ₱10,545.00 alleging that as a result of respondent's allowance of architect's fees, it overpaid its income tax for

1956 in the aforesaid amount of ₱10,545.00.

On May 9, 1972, after the case was submitted for decision, the Court resolved to reset it for hearing for the purpose of clarifying certain matters. Accordingly, the parties submitted additional evidence - testimonial and documentary.

The issues posed in this appeal are as follows:

1. Whether or not the fiscal agents' fees and the premium payments made by tenants in the housing projects in the respective sums of ₱10,000.00 and ₱42,896.79 are deductible or excludable from petitioner's gross income for 1956; and if in the affirmative, whether petitioner made an overpayment, as a result of respondent's allowance of architect's fees, and hence entitled to a refund;

2. Whether or not the dividends distributed or paid to participating policy holders for the period from 1953 to 1956 and the payments made by the tenants in housing projects for 1955 and 1956 are subject to the premium tax under Section 255 of the Revenue Code; and

3. Whether or not petitioner is required to withhold the income tax due on the compensation of its branch managers for the years 1955 and 1956 under Article 2 of Supplement A to Title II of the Revenue Code.

We are going to discuss the foregoing issues *ad seriatim*.

I

Fiscal Agents' Fees & Premium Payments Made by Tenants

A. Fiscal Agents' Fees, 1956 (₱10,000.00)

Respondent disallowed the fiscal agents' fees claimed by petitioner as deduction from its gross income for 1956 on the grounds that it failed to prove that said fees were actually spent; that they were ordinary and necessary; and that services had been actually rendered as required by Section 30(a)(1) of the Revenue Code.

This pretension is belied by documentary as well as testimonial evidence. According to Eligia Fernando, petitioner's treasurer, American International Reinsurance Co., Inc., parent company of petitioner and a subsidiary of C. V. Starr & Co., debited petitioner the sums of $2,500.00 on March 31, 1956 and $2,500.00 on September 19, 1956 for the fiscal agents' fees paid to C. V. Starr & Company covering the period from January 1, 1956 to December 31, 1956, in connection with its investments advices to petitioner; that petitioner rendered periodic reports to C. V. Starr & Company on investments and the latter commented on it; and that executives of C.V. Starr & Company came to the Philippines and attended petitioner's annual board meetings to discuss all matters concerning investments. Ricardo Bancod, treasurer of petitioner in 1964, certified that the fiscal agents' fees were paid to C. V. Starr & Company for rendering the following services:

1. To assist in the formulation of the investment policies of the company during its initial years of organization;

2. To give advice on specific investment projects or proposals which the company may refer for consultation;

3. To help or to give advice in life insurance application involving difficult question of medical and lay underwriting, especially in group insurance business; and

4. To assist the company in securing reinsurance facilities abroad for its operation.

An expense is considered "ordinary" when it is common, normal, or not unusual to incur in the trade or business of a particular taxpayer. The controlling guide is the kind of transaction involving the expenditure and its normalcy in the particular business. On the other hand, an expense is "necessary" if it is appropriate and helpful in developing and maintaining the taxpayer's business. All these criteria and principles rest, at least in part, on an underlying implication "that whether an expenditure is both 'ordinary and necessary' will depend upon a determination as to whether a hard-headed businessman would have incurred it under like circumstances." This is what is known as the doctrine of "commercial reality." (Canton Cotton Mills v. U.S., 94 F. Supp. 561; see also Mertens, Law of Federal Income Taxation, Vol. 4, par. 25.09.)

Every insurance business consists of two major activities: underwriting and investments. (Mertens, Law of Federal Income Taxation, Vol. 8, par. 44.04; Secs. 197-200, Act No. 2427 [Insurance Act].) Investment advisers are not uncommon in present-day business world and it seems normal for petitioner to seek advice from one who is dedicated to the study of investments.

B. Premium Payments Made by Tenants in Housing Projects in 1956 (₱42,896.79) -

Petitioner excluded the sum of ₱42,896.79 from its gross income for 1956 on the ground that it represents payments made by its tenants in the Quezon City housing projects, which are in the nature of self-insurance credited to the "Investment Reserve Fund" and treated by the company as mere deposits. It is argued that since deposits are not income, gain or profit, they are not taxable within the purview of Section 29(a) of the Revenue Code. Respondent, however, treated the said amount as premium payments on insurance subject to income tax.

It appears that petitioner maintained a housing project in Quezon City consisting of lots and houses sold to tenants under conditional sales contracts. The tenants who were insured with petitioner made installment payments with the company which were credited to the value of the lots and houses. Under the terms of the contract, a purchaser would be relieved of the further payment of his balance if he dies during the period of installments and because of this, part of said installment payments are premiums on insurance. Petitioner admits that the sum of ₱42,896.79 corresponds to said premium for 1956. As premiums, it should be subject to income tax.

Petitioner, however, considers the payments made by its tenants in its housing projects as mere deposits and not as premiums. We cannot subscribe to this pretension. The taxability of the payments here involved depends not upon the name attributed to it by the petitioner but upon the actual nature of the payments. Here, there is no question that the premiums were paid in consideration of the insurance taken by the purchasers or tenants whereby petitioner obligated to release them from making further payments if they die during the period of installments. There is, therefore, definitely an insurance contract between petitioner and the purchasers of the houses and lots and the premiums paid thereon are income to petitioner subject to income tax.

On the claim of petitioner that the premium payments in question were provisions for self-insurance which were credited to its investment reserve fund, suffice it to say that there is no showing that such reserve was authorized or required by law (see Mammoth Life & Accident Ins. Co., 6 BTA 869; Greenvile Coal Co., 3 BTA 1323; Spring Canyon Coal Co., 13 BTA 189). Moreover, these provisions are in the nature of a deduction which can be allowed only when plainly authorized (Helvering v. Inter-Mountain Life Ins. Co., 79 L. ed. 1227).

In view of our finding that the premium payments in the amount of ₱42,896.79 are subject to income tax and only the sum of ₱10,000.00, as fiscal agents' fees, is deductible from the gross income, instead of being entitled to a refund, petitioner is still liable for 1956 for the payment of the sum of ₱1,895.08 as deficiency income tax, inclusive of ½% monthly interest, computed as follows:

1956

Net income per return	₱1,412,898.85
Add: Premium income included in payments made by tenants in the housing projects which was credited to deposits of tenants	42,896.79
TOTAL	₱1,455,795.64
Less: 20% amortization of architects fees (disallowed in 1952)	37,159.76
Net income subject to tax	₱1,418,635.88
Tax due thereon	₱ 389,218.00
Less: Tax already assessed	387,612.00
Balance	₱ 1,606.00
Add: ½% monthly interest from 6/20/59 to 6/20/62	289.08
Total amount due & collectible	₱ 1,895.08

II

Deficiency Premium Taxes for 1953, 1954, 1955 & 1956 (₱115,743.66) -

The deficiency premium taxes, inclusive of 25% surcharge, broken down as follows:

1953	₱13,226.33
1954	17,308.48
1955	27,298.38
1956	57,910.47
Total	₱115,743.66

arose from:

(1) The treatment by respondent of the dividends paid to participating policy holders from 1953 to 1956 in the amount of ₱2,942,360.08 as part of petitioner's taxable receipts subject to the premium tax; and

(2) The treatment by respondent of the premium payments made by tenants in petitioner's housing projects for 1955 and 1956, in the amounts of ₱15,184.65 and ₱42,896.79, respectively, also as part of its taxable receipts subject to the premium tax.

A. Dividends Paid to Participating Policy Holders

Petitioner contends that the so-called "premium or policy dividends" paid to policy holders are not in the true sense dividends or earnings but rather return of premiums not includible in its taxable receipts pursuant to Section 255 of the Revenue Code. Respondent disagrees and insists that the amounts represent dividends or profits taken from the accumulated earnings or surplus of the corporation subject to the premium tax.

The exclusion of the "premium or policy dividends" from petitioner's taxable receipts for premium tax purposes is being justified under the provision of Section 255 of the Revenue Code, which, insofar as it is material to the issue at hand, is quoted hereunder:

> SEC. 255. Taxes on insurance premiums. - There shall be collected from every person, company, or corporation (except purely cooperative companies or associations) doing insurance business of any sort in the Philippines a tax of three per centum of the total premiums collected, whether such premiums are paid in money, notes, credits, or any substitute for money; but premiums refunded within six months after payment on account of rejection of risk or returned for other reason to person insured shall not be included in the taxable receipts; x x x x. (Underscoring supplied.

Revenue Regulations No. 2, particularly Section 48, partly provides:

> x x x Amounts received by an insured as a return of premiums paid by him under life insurance, endowments, or annuity contracts, such as the so-called "dividends" of a mutual insurance company which may be credited against the current premium, are not subject to tax. (Underscoring supplied.)

It appears that petitioner, during the years in question, conducted its life insurance business under the so-called "level premium plan." This plan is the one in general use by all life insurance companies. For a thorough understanding of how this plan operates, we are reproducing below petitioner's letter to respondent dated May 20, 1960, explaining its operation:

> Generally, life insurance companies are operating under the so-called "level premium plan." This plan contemplates a uniform maximum annual contribution by the policyholder during the life of the policy, the amount of payment during the earlier years being in excess of the current cost of his insurance, and the excess being applied to the creation of a reserve fund, which serves to maintain the insurance in the later years, when the stipulated level premium would otherwise be insufficient to meet the current cost of such insurance.
>
> In the case of nonparticipating policyholders, the premium is definitely fixed by the contract, while in the case of participating policyholders a maximum premium is stipulated, with a contract provision for its annual reduction as determined by the company. The stipulated maximum premium in a participating policy is invariably greater than the fixed premium in a nonparticipating policy issued at the same age and upon the same terms, other than as concerns the insured's right of participation.
>
> In participating policies, the life insurance companies try to secure to the participating policyholders their insurance at cost, and this result is accomplished by an annual reduction of the stipulated premium, the amount of such reduction being determined from year to year by the company.
>
> The calculation of premium rates for life insurance involves, first, the adoption of a table of mortality, showing the probable death rate for each age of life; second, the adoption of an assumed rate of interest, such as the company may reasonably expect to realize upon its invested assets during the lifetime of the policy. These two factors determine what is technically known as the "net" or "mathematical" premium, and are the sums considered sufficient and necessary to

pay all outstanding policies as they become claims, provided death occurs exactly in accordance with the table of mortality adopted, and the rate of interest earned on the investment of the reserve fund proves to be exactly equal to the rate assumed. To the "net premium" there is then added a sum, technically known as "loading," for the purpose of meeting the expense of conducting the business, as well as any unforseen contingencies, such as an abnormal death rate due to war or pestilence. The net or mathematical premium, increased by the "loading," constitutes the premium rates stipulated in the policies of insurance.

Premium rates so computed are, in the experience of life insurance companies, generally found to be in excess of their requirements. In a life insurance company such excess constitutes its margin of safety and must be liberal because it relies entirely upon its premiums to meet unusual contingencies. Such excess must be sufficiently large to assure the company's ability to pay its claims as they accrue beyond peradventure. Their policies may run for a period of 60 or even 96 years, and the stipulated premium cannot be increased after the policy is issued. In computing their rates the companies use, therefore, a table of mortality showing an admittedly higher death rate than that which will probably be realized. The assumed rate of interest on investments is also lower than that which the company expects to realize. The provision for expenses and contingencies is greater than would ordinarily be required. Life insurance companies have these three margins of safety, and, normally, each assumption is in excess of what is actually required. They result in excess or redundant premiums.

According to the practice of life insurance companies, at the end of the year, after ascertaining the cost of carrying the policy and the amount of excess premiums collected from participating policyholders, the company credits the policyholders with excess paid which is designated as "dividends."

> This premium overpayment technically designated in insurance circles as "dividends to policyholders" may be applied by the policyholders in reduction of the next premium, or to purchase additional insurance, or to shorten the premium-paying period of his policy, or to accelerate its maturity in case of an endowment policy.

This method of operation has never been disputed nor questioned by the respondent.

On the witness stand, petitioner's witness Eligia Fernando, testified that the dividends returned to participating policy holders are actually excess premiums, which are the difference between the premiums paid and the actual cost of carrying the risk as determined at the end of the year.

The question presented for our consideration is one of first impression in this jurisdiction. There are, however, precedents in the United States that can very well be applied in this jurisdiction.

Under the so-called "level premium plan," the amount of premium paid by a policy holder during the earlier years are in excess of the current cost of his insurance. Such excess, in life insurance company, constitutes its margin of safety and must be sufficiently large to assure the company's ability to pay its claim as they accrue beyond peradventure. The policy is issued at a fixed premium. That stipulated premium cannot be increased, but may be lessened annually by so much as the experience of the preceding year has determined it to have been greater than the cost of carrying the insurance, and the difference between the amount of the stipulated premium and the cost of carrying the risk constitutes the so-called dividend. The stipulated premium in participating policy is invariably greater than the fixed premium in non-participating policy issued at the same age and upon the same term. This is the kind of dividend which petitioner paid to its participating policy holders. This dividend, however, is not in any real sense a dividend. It operates merely to abate or reduce the stipulated premium to the extent that it has been determined by experience that the policy holder paid for his insurance during the preceding year more than it actually cost petitioner to carry the risk. This excess payment represents, not profits or receipts, but overpayment. It is an overpayment because being entitled to his insurance at cost and having paid by way of premiums more than it cost, he is equitably entitled to have such excess applied for his benefit.

> x x x The members contribute for a common object to a fund which is their common property; it turns out that they have contributed more than is needed, and therefore more than ought to have been contributed by them, for this object; and accordingly their next contribution is reduced by an amount equal to their proportion of this

> excess. I am at a loss to see how this can be considered as a "profit" arising or accruing to them from a trade or vocation which they carry on. It is true the alternative is allowed them of leaving the excess in the common fund, and so increasing their representatives' claim upon it in case of death; but I cannot think that this makes any difference. Mr. Bremner truly pointed out that, if these so-called bonuses were to be regarded as representing profits, it followed that, if the premiums were trebled, the profits would be increased in proportion. (New York Life Ins. Co. v. Styles, 59 L.J.Q.B. 291, L.R. 14 App. Cas. 381 [1889], cited in Mutual Benefit Life Ins. Co. v. Herold, 198 Fed. 199, aff'd Circuit Court of Appeals [3rd Cir.], 201 Fed. 918.)

The dividends herein paid have been apportioned and applied to the reduction of the premium named in the policy contract. In other words, what petitioner received was the difference between the stipulated premium and the so-called dividend. In such a case, the dividends are not sums paid to a policyholder and by him returned in cash. They are not income received (Mutual Benefit Life Ins. Co. v. Herold, supra). They are, therefore, not part of the "total premiums collected" but "premiums x x x returned for other reason to person insured x x" excludable from the taxable receipts. (Sec. 255, supra.) It can make no difference in principle whether the surplus is applied to the reduction of premium or paid in hard cash. In either case the operation is in substance a return of part of premiums previously collected for which tax has already been paid. (Mutual Benefit Life Ins. Co. v. Herold, supra.) What petitioner receives by way of income and all that it is liable to be taxed for is the reduced premium.

> If, therefore, a policy holder by the express provision of his policy elects to have a previous overpayment of premium applied in reduction of a succeeding stipulated premium, what he pays, and all that he pays, or can be required to pay, is the reduced premium, and that is all that the company receives by way of income, and all that it is liable to be taxed for. (Mutual Benefit Life Ins. Co. v. Herold, supra.)

It is urged that the dividends were taken from surplus and paid out to participating policy holders as dividends in the real sense. In resolving a similar argument, the Federal Court of the U. S. held:

> x x x. But it may be urged that the fund for which the so-called dividends are declared on mutual policies is likewise largely derived from interest on the company's investments, and that this shows that in a real sense such dividends were, after all, declared from the earnings, profits, or income of the company. This proposition might be entitled to weight, were it not for the fact that, in so far as the fund from which such dividends are declared is produced from interest on the company's invested funds, it has already been subjected to, and has paid, taxes under the act in question.
>
> Furthermore, while perhaps not illegal, it is in a sense unfair, and therefore presumably contrary to the intention of Congress, as between a mutual company and a stock company, to tax the dividends in question as income received. The policy holder in a stock company pays a uniform and fixed

> premium each year. The premium in his case is not "loaded," but is presumed to represent cost as nearly as may be, for the reason that the stability of his policy is assured by the stock of the company, and not, as in the mutual plan, by premium payments avowedly in excess of the cost of the insurance. It would seem to be fair and equitable, therefore, between the two classes of companies, to tax them upon the premiums actually paid them by their policy holders, and not to tax one class upon premium payments actually received and the other upon payments which at the utmost are only "constructively received." (Mutual Benefit Life Ins. Co. v. Herold, *supra*.)

In view of the above, we are, therefore, of the opinion that the dividends paid to participating policy holders are in reality return of excess premiums which were properly excluded from petitioner's taxable receipts for purposes of computing the premium tax.

B. Premium Payments Made by Tenants in Housing Projects in 1955 and 1956 (₱15,184.65 & ₱42,896.79) -

This item represents payments made by tenants in petitioner's housing projects. In our disposition of the second issue, *supra*, we hold that there is definitely an insurance on the conditional sales contracts executed by the tenants in connection with said housing projects. Consequently, the payments made by the tenants corresponding to the premium on said insurance, in the respective sums of ₱15,184.65 and ₱42,896.79 for 1955 and 1956, are subject to the premium tax under Section 255 of the Revenue Code. Accordingly, petitioner is held liable for the payment of the sums of ₱379.61 and ₱1,608.63 as deficiency premium taxes and surcharges for the years 1955 and 1956, respectively, computed as follows:

1 9 5 5

Undeclared premium income-payments made by tenants in housing projects --------------	₱15,184.65
Tax due thereon @ 2% ------------	₱ 303.69
25% surcharge ------------------	75.92
Deficiency tax &surcharge -------	₱ 379.61

1 9 5 6

Undeclared premium income-payments made by tenants in housing projects -------------	₱42,896.79
Tax due thereon @ 3% ------------	₱ 1,286.90
25% surcharge ------------------	321.73
Deficiency tax & surcharge ------	₱ 1,608.63

III

Withholding Tax, 1954-1956 (₱50,262.00)

Respondent has assessed petitioner the sum of ₱50,262.00, representing withholding tax, surcharge and compromise penalty, allegedly for failure of petitioner to withhold the income tax on the overriding commissions paid to its eighteen (18) unit and branch managers (managers for short) for the period from 1954 to 1956.

The basis of the said withholding tax assessment can be clearly gathered from the indorsement of respondent's examiner Emilia C. de la Cruz to the Chief, Manila Examiners, dated October 1, 1959, which we quote in part as follows:

> The company did not subject to withholding tax the amount of income received from it by its eighteen (18) Unit and Branch Managers throughout the country. They maintain that the relation between the company and its agents is not of an employer and employee relationship and in as much as the Unit and Branch Managers of the company are also at the same time agents of the company, their agents' commissions of which are exempt from withholding tax, they treated all payments to them equally as exempt under the withholding tax law. These "Units and Branch Managers" of the company receive a fixed monthly salaries as specified in their contract of employment with the company aside from their overriding income or commissions they receive periodically or credited to their accounts. (Underscoring supplied.)

On the other hand, petitioner contends that the commissions paid to these managers are not subject to the withholding tax because they are not its employees.

As correctly pointed out by respondent, the determination of the issue as to whether or not petitioner is subject to the withholding tax hinges on the question as to whether these managers are considered "employees" under the existing law and implementing regulations.

We will go first to the applicable law. The Withholding Tax Law (Supplement A to Title II of the Revenue Code), so far as pertinent, provides:

ART. 1. Definition.- As used in this supplement - (a) Wages.- The term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash; except that such term shall not include remuneration paid -

xx xx xx xx

(c) Employee.- The term "employee" refers to any individual who is the recipient of wages and includes an officer, employee, or elective official of the Government of the Philippines or any political subdivision, agency or instrumentality thereof. The term "employee" also includes an officer of a corporation.

(d) Employer.- The term "employer" means the person for whom an individual performs or performed any service, of whatever nature, as the employee of such person, except that -

xx xx xx xx

ART. 2. Income tax collected at source.- (a) Requirement of withholding.- Every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with a withholding table to be prepared by the Secretary of Finance. (Underscoring supplied.)

Implementing Revenue Regulations No. V-8 define the terms "employee" and "employer" as follows:

SEC. 5. Employee.- The term "employee" includes every individual performing services if the relationship between him and the person for whom he performs such services is the legal relationship of employer and employee. x x

Generally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. xx xx. In general, if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is not an employee.

SEC. 6. The term employer means any person for whom an individual performs or performed any service, of whatever nature, as the employee of such person. (Underscoring supplied.)

Petitioner presented Exhibits E, E-1 to E-5 to prove the terms of the contract between petitioner and a branch/agency unit manager but these documents plainly do not refer to such relationship. These patently refer to a contract of a mere agent. The nature of the contractual relations between petitioner and its unit manager can only be pieced out from the testimony of Jesus C. Aldeguer and Eligia Fernando, and Exhibits C and F.

The aforesaid evidence show that petitioner provides the unit manager with office space, equipment and a limited budget to finance operation. Aside from these, the manager gets a basic commission which he receives monthly to help him financially in the recruitment and training of agents. If he undertakes promotional activities he shoulders the expenses. He also receives quarterly a supplementary commission which is graduated on the basis of the total production of the unit. These two kinds of commissions are entered in the books of petitioner as supplementary and basic monthly salaries. He is authorized to give cash advances to agents in case of emergency but must see to it that they are deducted from the agents' commissions. The job of a unit manager is to recruit agents, train and motivate them, help them sell insurance, control their expenses, and assist them in selling insurance or closing a deal. He himself does not sell. Maybe he does sometimes, but that is not the purpose for his appointment as manager. If he sells insurance, he receives a commission for the sale as any ordinary agent - a commission which is apart from his basic and supplementary commission. If he does so he acts not as a manager but as a mere agent. He has a free hand in managing his unit but he is bound by regulations of the petitioner. He has no office hours but is subject to dismissal for abandonment of "duties as unit manager". In contrast, his agents follow no routine and work at their own leisure for they cannot be required to work. Of course they are subject to dismissal if they are inactive for several years.

In Luzon Stevedoring Co. v. Trinidad, 43 Phil. 803, it was ruled that the true test of an independent contractor "would seem to be that he renders the service in the course of an independent occupation, representing the will of his employer only as to the result of his work, and not as to the means by which it is accomplished." On the other hand, under Revenue Regulations No. V-8, an employer-employee relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work, but also as to the details and means by which the result is accomplished. It is not necessary that the employer actually directs or controls the manner in which the services are performed; it is sufficient if it has the right to do so. If the employer-employee relationship in fact exists, the designation or description of the relationship as anything else does not alter such fact.

We are of the persuasion that the unit manager is not an independent contractor as petitioner contends but is more nearly an employee. The manager has duties to perform, to wit: take charge of an office of petitioner and run it; recruit, train, motivate and supervise the agents; control the latter's expenses and help them in selling insurance or closing a deal; disburse funds of petitioner for agents in case of emergency and see to it that they are reimbursed from the agents' commissions. These recited duties, which more or less require constant attention, so much so that in the case of Unit Manager Aldeguer he sees to it that he reports regularly without restriction as to time, are in effect the means and methods by which to accomplish the desired result. And in this matter he is subject to control for he is subject to dismissal for abandonment of his "duties as manager". True enough, he has a freehand in the management of his unit but that freehand is within the context of his duties, a freehand that is inherent in the position, for managers are appointed for their judgment and good sense, not for their capacity to perform menial work as automatons. He may have been partly appointed to accomplish a desired result but it seems that he was hired more for the labor which petitioner considers as essential for the result to be accomplished and the proof is that dismissal is not based on a quota of accomplishment but for "abandonment of his duties as managers".

To consider the situation of the unit manager as in the level of an agent, as petitioner does, is not correct. The agent belongs to a different category. He is unfettered by a specification of duties applicable to managers. He has only to sell insurance guided by what he learned from the manager and by his own instinct and he goes about at his own leisure for under his contract he can not be compelled to go out and sell insurance. Of him it can really be said that he was made an agent for the result to be accomplished, uncontrolled as to the means and methods for the accomplishment of the result.

Respondent imposed a compromise penalty in this item and this is not justifiable. It is now well settled that the same cannot be imposed or of the taxpayer. (Coll. of Int. Rev. v. University of Sto. Tomas, et al., G.R. Nos. L-11274 and L-11280, Nov. 28, 1958.

This item is labeled in the assessment as deficiency withholding tax for 1954 to 1956 and the memoranda of the parties refer to it with that label. The record however shows that it does not refer to deficiency withholding tax but to the 25% surcharge for failure to withhold tax on the over-riding or supplementary commissions paid to its unit and branch managers. This item should be reduced to ₱50,112.00 because, as shown above, the compromise penalty should not be included therein.

WHEREFORE, the decision of respondent appealed from is, therefore, modified. Accordingly, petitioner is hereby ordered to pay respondent the sum of ₱1,895.08, as deficiency income tax, inclusive of ½% monthly interest for 1956; the total sum of ₱1,988.24, as deficiency premium taxes and surcharges, for 1955 and 1956; and the sum of ₱50,112.00 representing surcharge for failure to withhold tax on the over-riding or supplementary commissions paid to its unit and branch managers. In addition to the deficiency income tax, petitioner is likewise ordered to pay 5% surcharge

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and 1% monthly interest subject to the limitation prescribed by Section 51(e) of the Revenue Code, as amended. Without pronouncement as to costs.

SO ORDERED.

Quezon City, November 12, 1973.

RAMON L. AVANCEÑA
Associate Judge

WE CONCUR:

ROMAN M. UMALI
Presiding Judge

ESTANISLAO R. ALVAREZ
Associate Judge