REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

JOSE P. FERNANDEZ,
Petitioner,

versus CTA CASE NO. 1756

THE ACTING COMMISSIONER
OF INTERNAL REVENUE,
Respondent.

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

Jan. 16, 1970

D E C I S I O N

Petitioner appealed from the decisions of respondent assessing petitioner for deficiency income taxes of ₱10,881.40 and ₱8,060.28, plus ₱30.00 and ₱140.00 compromise penalties, for 1960 and 1961, respectively.

Petitioner filed his income tax returns for 1960 and 1961 wherein he claimed certain deductions from his gross income (Exhs. A & B, pp. 2-3, 31-34, BIR rec.). After verification and investigation of the income tax return and books of accounts of petitioner for 1960, respondent issued a deficiency income tax assessment dated May 31, 1965 against the former demanding the payment of ₱10,881.40, plus the sum of ₱30.00 as compromise penalty, because respondent disallowed petitioner's claim for deductions of: (1) losses incurred in the breeding and training of race horses, and (2) contributions to charitable institutions, computed and itemized as follows:

Net income disclosed by the return as audited		₱ 62,075.46
Unallowable deductions & additional income:		
(1) Contribution-unsupported	₱3,706.00	
(2) Loss on Horse Racing (Not in connection with the business). . .	19,790.17	
Total Adjustments		23,496.17
Net income as per investigation		₱ 85,571.63
Less personal and additional exemptions		1,800.00
Amount subject to tax		₱ 83,771.63
Income tax due thereon		₱ 29,090.00
Less amount already assessed . . .		18,401.00
B a l a n c e		₱ 10,689.00
½% monthly interest from 4-16-61 to 18%.		192.40
Total deficiency income tax due. .		₱ 10,881.40
Compromise for no books of accounts	₱ 30.00	
for no balance sheet (V-13)	10.00	
TOTAL COMPROMISES DUE	₱ 30.00	

(Exhs. D & 3, p. 13, BIR rec.)

Respondent likewise disallowed similar claims of deduction by petitioner and issued on April 15, 1966, an assessment notice against him for 1961 deficiency income tax of ₱8,060.28, plus ₱140.00 as compromise penalty, computed and itemized as follows:

Net income disclosed by the return as audited		₱ 63,290.54
Unallowable deductions & additional income:		
(1) Expenses in horse breeding up to the extent of income in horse races. This was disallowed		

because horse breeding and races was only a hobby on the part of taxpayer and not a business as presented in the return . . . . ₱13,626.15
(2) Contributions unsupported 3,581.00
Total adjustments . . ₱17,210.15

Net income as per investigation . .	₱80,500.69
Less personal exemption	1,800.00
Amount subject to tax	₱78,700.69
Income tax due thereon	₱26,682.00
Less amount already assessed . . .	18,936.00
B a l a n c e	₱ 7,746.00
½% monthly interest from 4/15/61 to 4/15/65 (18%)	314.28
Total deficiency income tax due . .	₱ 8,060.28

Compromise:
No comparative Profit and Loss . . . . . . ₱50.00
No certification by Certified Public Accountant 70.00
No balance sheets . 20.00
Total compromise due . ₱140.00
(Exh. G, p. 47, BIR rec.)

In a letter dated July 14, 1965 which was received by respondent on the same date, petitioner requested the reconsideration of the said 1960 deficiency income tax assessment, but the same was denied by respondent in his letter of April 11, 1966 which was received by petitioner on April 19, 1966 (p. 26, BIR rec. and p. 1, par. 4, Petition, CTA rec.). Thereafter, petitioner filed with this Court a petition for review assailing respondent's deficiency income tax assessments for 1960 and 1961.

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

> (1) Whether or not this Court has jurisdiction to entertain the appeal on the deficiency income tax assessment for 1961;
>
> (2) Whether or not petitioner is engaged in the business of breeding and training race horses so as to entitle him to deduct from his gross income the expenses incurred therein; and
>
> (3) Whether or not petitioner's claim for charitable contributions should be allowed as deduction from gross income.

FIRST ISSUE:

Respondent raised in his memorandum the issue of whether or not this Court has jurisdiction to entertain the appeal on the 1961 deficiency income tax assessment in question. He contends that the aforesaid assessment has never been contested or disputed by petitioner and, therefore, there is no decision of respondent which is appealable to this Court.

We find respondent's contention well taken. The BIR records show that the 1961 deficiency income tax assessment dated April 15, 1966 had never been contested or disputed by petitioner. The appeal, therefore, of petitioner emanates from the assessment itself and not from a decision of the respondent Commissioner of Internal Revenue on a disputed assessment.

Section 7(1) of Republic Act No. 1125 provides as follows:

> SEC. 7. Jurisdiction. - The Court of Tax Appeals shall exercise exclusive appellate jurisdiction to review by appeal, as herein provided -
>
> (1) Decisions of the Collector of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties imposed in relation thereto, or other matters arising under the National Internal Revenue Code or other law or part of law administered by the Bureau of Internal Revenue.
> (Underlining supplied.)

An assessment issued by the respondent against a taxpayer is not appealable to this Court. Only the decision of respondent on a disputed assessment is appealable thereto. An assessment issued by the Commissioner of Internal Revenue becomes a disputed assessment where the taxpayer questions its legality either by protest, requests for cancellation, reconsideration or reinvestigation. It is the conclusive answer or decision of respondent to the protest, requests for cancellation, reconsideration, or reinvestigation of the taxpayer which is appealable to this Court.

In other words, the decision (not the assessment itself) of respondent on a disputed assessment is appealable to the Court of Tax Appeals. (St.

Stephen's Ass. v. Coll. of Int. Rev. 104 Phil. 314; Comm. of Int. Rev. v. Villa, et al., G.R. No. L-23988, Jan. 2, 1968.) Thus, our Supreme Court in the above-cited case of Villa held, among others, as follows:

> . . . Note that the law uses the word "decisions", not "assessments", thus further indicating the legislative intention to subject to judicial review the decision of the Commissioner on the protest against an assessment but not the assessment itself.
>
> Since in the instant case the taxpayer appealed from the assessment of the Commissioner of Internal Revenue without previously contesting the same, the appeal was premature and the Court of Tax Appeals had no jurisdiction to entertain said appeal. For, as stated, the jurisdiction of the Tax Court is to review by appeal decisions of the Commissioner of Internal Revenue on disputed assessments. The Tax Court is a court of special jurisdiction. As such, it can take cognizance only of such matters as are clearly within its jurisdiction. (Underlining supplied.)

Consequently, the appeal involving the 1961 deficiency income tax assessment issued by respondent against petitioner should be, as it is hereby, dismissed for lack of jurisdiction.

SECOND ISSUE:

Respondent claims that the breeding and maintenance of race horses by petitioner is merely a hobby and not a business conducted for profit because: (1) petitioner's income from said activity came solely from prizes of winning horses while the expenses for breeding and raising of race horses are excessive and not commensurate with the income derived therefrom; (2) petitioner's income tax returns for the past five years, inclusive of 1960 and 1961, reflected losses in the venture in question; (3) petitioner is known as a horse racing fan whose pictures appeared in the newspapers together with his winning horses; and (4) petitioner's executive position in various business corporations is incompatible and alien to the business of breeding and raising of race horses.

We cannot subscribe to respondent's view. There is no incompatibility in the work of a person who is an executive in various business corporations and at the same time engaging in the business of breeding and raising of race horses. If the taxpayer devotes time, attention and labor to the latter undertaking with the intention of deriving profit therefrom, he is deemed to be engaged in business. In the case of Commissioner of Internal Revenue v. Field (67 F [2d] 876-878), which is similar to the case at bar, the taxpayer was engaged in banking and other business enterprises, including the operation of a farm and horse breeding and racing. In his income tax returns, taxpayer charged off losses sustained by him in the operation of a farm and racing stable. The U.S. Commissioner of Internal Revenue, like our respondent, refused to allow the deduction of losses from gross income because the taxpayer was operating his farm and racing stable as a hobby and not as a business for profit. Both the U. S. Board of Tax Appeals and the Circuit Court of Appeals allowed the deduction of said losses from the taxpayer's gross income and ruled as follows:

> ". . . the court repeated a definition of business as 'That which occupies the time, attention, and labor of men for the purpose of a livelihood or profit.' It is not essential that the taxpayer be engaged solely in one business. He may have interests in several enterprises among which he divides his time. His intention is important. . .
>
> "In the instant case, there is substantial evidence that the enterprises were conducted as a business for profit and with an expectation of ultimate profits. We cannot say that the expectation of profits is unreasonable or forecast continuous losses in the light of experience in cattle or horse breeding and racing. If the right to deduct losses under the statute required that profit appear to the court to be possible, that requirement would be quite general and would be applicable to any enterprise, whether it was farming, manufacturing, or promotion of any character. We may not, in this way, foredoom any business venture. Cattle breeding and horse racing projects are old. Some have been profitable; others have not. It is a matter of intention and

> good faith, and all the circumstances in the particular case must be our guide. In this case we think the respondent embarked in these enterprises with the expectation of making profits; at least he did so with an earnest and honest intention."

Again, in the case of Commissioner of Internal Revenue v. Widener (33 F 2d 833), the deduction of losses for breeding and maintenance of race horses was sustained by the Court. It was held therein that:

> "The first question to be answered is whether the activities of the petitioners in respect of their racing and breeding stables constituted a business. An affirmative answer carries with it the right to deduct the expenses of their operation and the losses sustained.
>
> "The evidence establishes that the petitioners were engaged in the business of breeding, buying, and selling race horses and entering them in racing contests for gain. They testified that they sought at all times to make a success of the enterprises and that their only measure of success was financial gain. Their horses were purchased as investments, the selective breeding was influenced by the thought of winning stakes and purses, and the disposition of horses was either for profit by sale or for riddance of those not economically useful. These are among the characteristics of business. Wilson v. Eishner (C. C. A.) 282 F. 38, 2 A.F.T.R. 1744. The fact that petitioners were wealthy enough to afford a hazardous occupation in which they found pleasure despite discouraging losses does not estab-

lish the essential nature of the occupation. If they were utterly indifferent to whether there was loss or gain, or if it were shown that the stables were an incident to the social or domestic aspects of their daily lives, the result might be against them, as in Thacer v. Lowe (D. C.) 288 F. 994, 2 A.F.T.R. 1931. Instead, it appears that they devoted themselves seriously and assiduously to the economic promotion of their stables, always in the hope that profit would result. The winning of a single race or the chance purchase of a yearling might at any time convert steady losses into a net profit, and make it a successful business. The expenses and losses are deductible, and the determination of respondent in respect of the first two assignments of error is reversed. . . ." (Underscoring supplied.)

In the instant case, the evidence adduced during the trial shows that petitioner has been engaged in the business of breeding horses since 1950 (pp. 7-8, 40, t.s.n.); that when he began breeding horses, it was his purpose and intention to realize a profit therefrom by entering the said horses in races (pp. 8, 38, t.s.n.); that at the beginning of the breeding venture, he had only five to six horses which accounted for his losses (pp. 32, 40-41, t.s.n.), but he calculated that after importing some good breeds, he would make money by 1968 (p. 11, t.s.n.); that he tried to cross-breed Batangas horses with local stallions, but the resulting breed was not satisfactory and, he imported brood mares from California and stallions from England, to make his projection come true; that petitioner has established a stable in Manila and a stud farm in Dalupiri where cattle is also raised under the resident managership of a veterinarian (pp. 39-40, t.s.n.); that he has hired employees and workers for the necessary maintenance of such farms (pp. 37-38, 39, t.s.n.); and that he supervises the stable in San Francisco del Monte almost everyday and during his spare time (p. 45, t.s.n.). In short, the actuations of petitioner indicate that he is engaged in the business of breeding and training of race horses. Considering further the value of the expensive horses and the high cost of their maintenance, we are prone to believe that petitioner is engaged in a profit venture, and not in a mere hobby as contended by respondent. The mere fact that petitioner has been continuously losing in the venture does not negate the profit motive of petitioner. Furthermore, evidence was introduced to show that losses in the breeding venture was diminishing, justifying petitioner's projection that by 1968 he would be making a profit.

> "<u>Losses of Racing and Breeding Stables</u>.—The operation of a racing stable or a breeding farm being in

its essence a risky business, frequently giving rise to consecutive periods of annual losses, has occasioned considerable tax litigation. While horse racing is a sport, it may nevertheless constitute a business. The existence of substantial financial risk in the conduct of such business does not necessarily convert it into a hobby any more than in the case of any other adventurous business, such as mining, oil development or trading in securities. All of these businesses involve a substantial risk factor and frequently occasion periods of continued losses. The Bureau has in practice frequently disallowed racing and breeding stable losses on the ground that the taxpayer had not entered into the transaction for the purpose of deriving a profit and was not operating the stable with that purpose in mind during the taxable year. In the cases in which the Bureau has recognized that the transaction was originally entered into for the purpose of making a profit, it has usually denied deductions in subsequent years where the operation of the stable has shown a consistent series of losses. Such disallowances has been premised apparently on the assumption that a person would not continue in a business which has consistently shown losses unless such continuance was motivated primarily by the pleasure derived therefrom. In most cases this is a mere assumption and must be supported by or yield to the actual facts involved. It is opposed by another reasonable assumption that most taxpayers do not ordinarily indulge in extravagant hobbies involving continued losses. Owners of race horses and breeders are ordinarily optimistic persons, confident of their ability to breed a successful strain of horse or to develop one or more outstandingly successful horses which can carry off substantial stakes and purses or furnish large stud fees, and which can be sold at commensurate prices.

"There must exist, at the inception of the venture, an intention to derive income therefrom and ordinarily an expectation of profit. A venture once started as a business does not become a hobby because of the fact that losses have been sustained. While the profit motive continues, it is immaterial whether the expectation of profit is reasonable so long as it is bona fide. The courts will not ordinarily substitute their own predictions as to the likelihood of profit for those of the person operating the stable. . . . The standards of the ordinary businessman as to whether the business is or is not a successful one are obviously not applicable. In view of the character of horse racing and horse breeding, the financial result is frequently either a feast or a famine. To steady the curve requires considerable experience and skill.

"It has been held in a number of cases that the mere fact that the venture has shown continuous losses is not alone sufficient to warrant the conclusion that the stable is not being operated for profit." (Mertens, Law of Federal Income Taxation, Vol. 5, § 28.74, Chap. 28, pages 326-327, 1953 Revised Edition.)

We are satisfied from the evidence that the losses were incurred by petitioner in the business of breeding and training of race horses. The said losses are, therefore, deductible from petitioner's gross income.

THIRD ISSUE:

Respondent disallowed petitioner's claim for certain deductions of contribution because they are not supported or evidenced by receipts. Section 30(h) of the Tax Code, and Section 116 of Revenue Regulations No. 2, which are relevant to the question at issue, read as follows:

> SEC. 30. Deductions from gross income.—In computing net income there shall be allowed as deductions -
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> x x x x x
>
> (h) Charitable and other contributions.—Contributions or gifts actually paid or made within the taxable year to or for the use of the Government of the Philippines or any political subdivision thereof for exclusive public purposes, or to domestic corporations or associations organized and operated exclusively for religious, charitable, scientific, athletic, cultural or educational purposes or for the rehabilitation of veterans, or to societies for the prevention of cruelty to children or animals, no part of the net income of which inures to the benefit of any private stockholder or individual to an amount not in excess of six per centum in the case of an individual, and three per centum in the case of a corporation, of the taxpayer's taxable net income as computed without the benefit of this paragraph. Such contributions or gift shall be allowable as deductions only if verified under rules and regulations prescribed by the Secretary of Finance. (As amended by Section 7, Republic Act No. 82) (Underscoring supplied.)
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> SECTION 116. When Contributions or Gifts May be Deducted -
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> x x x x x

> In connection with claims for deductions, there shall be stated on returns of income the name and address of each organization to which a gift was made and approximate date and the amount of the gift in each case. Where the gift is other than money, the basis for calculation of the amount thereof shall be the fair market value of the property at the time of the gift. Contributions or gifts paid or made to corporations or associations specified in the law will only be allowed as deduction when the taxpayer attaches to his return the receipt duly signed by the responsible officer of the corporations or associations to which the contributions or gifts has been paid or made. If desired, said receipts will be returned to the taxpayer after they have served their purpose.

In this case, petitioner's secretary testified that contributions were indeed made by petitioner to various institutions, namely: Hospicio de San Jose, Cerebral Palsy, Philippine Red Cross and the Community Chest (pp. 17, 18 and 22, t.s.n.). Considering petitioner's position as a high executive in various business corporations, we are of the opinion that the sum of ₱500.00 may be allowed as a reasonable deduction from his gross income in 1960, in line with decisions of this Court, wherein it was held:

> . . . A careful perusal of Section 30(b) of the Tax Code shows that the law does not specifically prohibit the introduction of other competent

evidence to prove that contributions have been made. It is true that Section 116 of Revenue Regulations No. 2 requires that the receipt duly signed by a responsible officer of the recipient corporation or association be attached to the income tax return in order that the deduction may be allowed, but this requirement is merely for the convenience and facility of the Bureau of Internal Revenue in verifying income tax returns. This administrative requirement cannot deprive the taxpayer of his right to prove his contributions in accordance with the rules of evidence. Deduction of amounts contributed to charity is based on public policy (U.S. vs. Pleasants, 305 U.S. 357, 59 Ct. 281), and provisions allowing deductions of charitable contributions should not be narrowly construed (Estate of J. B. Whitehead, 3 TC 40, 48, aff'd sub nom. Comm. v. Citizens and Southern Nat. Bank, 147 F(2d) 977 CCA 5th, 1945). (Helen T. Ramirez v. Commissioner of Internal Revenue, C.T.A. Case No. 544, Sept. 14, 1959.)

. . . It is true that petitioner failed to produce receipts of payments to charitable organizations, but we are aware of the fact that in this country, contributions to the Boy Scouts, Girl Scouts, Community Chest, Anti-Tuberculosis Society and other charitable institutions are inevitable. Consequently, we are of the opinion that the sum of ₱800.00 is a proper deduction from petitioner's gross income in 1950. (Gonzalo P. Nava v. Comm. of Internal Revenue, C.T.A. Case No. 568, Sept. 25, 1961.)

Anent the suggested compromise penalty of ₱30.00 to be paid by the petitioner for his alleged failure to keep books of accounts as required by

Section 334 of the Tax Code, and to submit a balance sheet as required by the Bookkeeping Regulations, suffice it to say that respondent does not have any power to impose a compromise penalty without the consent of petitioner (Coll. v. U.S.T., et al., G.R. Nos. L-11274 and L-11280, Nov. 28, 1958; Coll. v. Bautista, et al., G.R. Nos. L-12250 and L-12259, May 27, 1959; Philippine International Fair, Inc. v. Coll. of Int. Revenue, G.R. Nos. L-12928 & L-12932, March 31, 1962). The imposition, therefore, of the compromise penalty is illegal.

WHEREFORE, the appeal covering the 1961 deficiency income tax assessment against petitioner is dismissed for lack of jurisdiction.

As to the 1960 deficiency income tax assessment, the same is modified. Consequently, petitioner is hereby ordered to pay respondent the sum of ₱1,664.98 as deficiency income tax for 1960, computed as follows:

Net income per return	₱ 62,075.46
Unallowable deduction (unsupported contributions)	3,206.00
Net income per investigation. .	₱ 65,281.46
Less personal exemption	1,800.00
Amount subject to tax	₱ 63,481.46
Income tax due thereon	₱ 19,812.00
Less amount already assessed. .	18,401.00
B a l a n c e	₱ 1,411.00

½% mo. interest from 4/16/61 to 4/15/64	. .	₱ 253.98
TOTAL DEFICIENCY TAX DUE	. . . .	₱ 1,664.98

If the deficiency income tax and interest are 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 deficiency income tax plus additional interest at the rate of one (1%) per cent a month, computed from the date this decision becomes final until paid, provided that the maximum amount that may be collected as 1% monthly interest shall not exceed the amount corresponding to a period of three (3) years, or 36%, in accordance with Section 51(e) of the Tax Code, as amended by Republic Act No. 2343. Without pronouncement as to costs.

SO ORDERED.

Quezon City, January 16, 1970.

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