REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

BANICO and SONS, INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 4330

BUREAU OF INTERNAL REVENUE and EUFRACIO D. SANTOS, IN HIS CAPACITY AS DEPUTY COMMISSIONER OF INTERNAL REVENUE,
Respondents.

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9/21/93

D E C I S I O N

This case is an appeal from the decision of the respondent, Bureau of Internal Revenue, assessing the petitioner the sums of P75,778.38 as deficiency income tax due to disallowance of various expenses as deductions and P96,992.02 as deficiency surtax due to alleged unreasonable accumulation of profits, both for the taxable year 1979.

The facts of the case are as follows:

On January 11, 1985, petitioner Banico and Sons, Inc., a corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines, received a demand letter with corresponding assessment notices, all dated July 11, 1984 from the respondent assessing the corporation for deficiency income tax and surtax, details of which are shown below:

Deficiency Income Tax
(C.T.A. Records, p. 12)

Gross income:		
Rent		P144,000.00
Dividend		83,589.14
Other income		89,711.25
Gain on sale of securities		133,044.13
Total gross income		P450,344.52
Less: Income subjected to final tax:		
Dividend	P 83,589.14	
Share - Equitable Banking Corporation	69,185.00	
Gain on sale of securities	133,044.13	285,818.27
Taxable gross income		P164,526.25
Less: Allowable deductions:		
Interest and bank charges	P 8,599.48	
Taxes and licenses	3,372.19	
Donations and contributions	4,519.40	
Accountant and auditor's fees	1,000.00	
SSS, Medicare and EC	261.70	
Stationery and office supplies	646.25	18,399.02
Net taxable income		P146,127.23
Tax due thereon		P 48,450.89
Less: Tax credit		543.19
Deficiency income tax		P 47,907.70
Add: 14% int. fr. 4/16/80 to 7/31/80		1,952.40
20% int. fr. 8/01/80 to 4/15/83		25,918.28
Total Amount Due and Collectible		P 75,778.38

Deficiency Surtax
(C.T.A. Records, p. 13)

Total gross income (per statement)	P450,344.52
Less: Total expenses	233,963.84
Net Income per statement	P216,380.68
Add: Depreciation deducted	78,802.59
Total net income	P295,183.27
Less: Assessments for deficiency income	49,906.81
Net profit	P245,276.45
25% surtax	P 61,319.11
Add: 14% int. fr. 4/16/80 to 7/31/80	2,498.96
20% int. fr. 8/01/80 to 4/15/83	33,173.95
Total Amount Due and Collectible	P 96,992.02

Petitioner protested the above assessments on January 21, 1985 through a letter dated January 18, 1985.

On December 22, 1988, respondent issued its final decision, in a letter dated December 6, 1988 signed by co-respondent Deputy Commissioner Eufracio D. Santos, denying petitioner's protest for lack of legal and factual basis.

Petitioner thus sent, on January 20, 1989 through registered mail (C.T.A. Records, p. 27), this petition for review which was received by this Court on January 28, 1989.

Respondent on the other hand, in his answer and by way of special and affirmative defenses alleged among others, that:

1) The assessments have already become final, executory and collectible, pursuant to Sections 7 and 11 of Republic Act (R.A.) No. 1125, because the petition for review was filed only on January 28, 1989, or thirty seven (37) days after petitioner received on December 22, 1988 the letter denying his protest to the assessments;

2) The expenses disallowed mainly consists of rentals, dividends, interests, etc. which are passive and fixed income that cannot be considered as ordinary and necessary expenses deductible under the Tax Code;

3) The cash position of the company warrants a declaration of cash dividends to shareholders as the investments made were mainly on speculative securities;

4) Petitioner, being a closely held family corporation organized as a mere holding company, there exists a prima facie evidence of a scheme to avoid the tax upon its shareholders; and

5) The assessments in question were issued in accordance with law.

Before this Court for consideration are the following issues:

1. Whether or not the petition for review was filed within the prescriptive period of thirty (30) days, in compliance with Sections 7 and 11 of R.A. No. 1125;

2. Whether or not petitioner is liable for deficiency income tax amounting to P75,778.38; and

3. Whether or not petitioner is guilty of unreasonable accumulation of profits making it liable for deficiency surtax in the amount of P96,992.02.

This Court, in response to respondent's defense of prescription, holds that the petition for review was filed within the thirty-day period prescribed in Sections 7 and 11 of R.A. No. 1125. Section 1 of Rule 13 of the Rules of Court provides:

> "Section 1. *Filing with the court, defined*. - The filing of pleadings, appearances, motions, notices, orders and other papers with the court as required by these rules shall be made by filing them

> personally with the clerk of the court or by sending them by registered mail. In the first case, the clerk shall endorse on the pleading the date and hour of filing. In the second case, the date of the mailing of motions, pleadings, or any other papers or payments or deposits, as shown by the post office stamp on the envelope or the registry receipt, shall be considered as the date of their filing, payment, or deposit in court. The envelope shall be attached to the record of the case." (Underscoring supplied)

Thus, it has been held that when a pleading, such as the herein petition for review, is sent by registered mail, the date of mailing of such pleading, as shown by the post office stamp on the envelope or registry receipt, shall be considered the date of filing (**Mercader vs. Commissioner of Internal Revenue**, C.T.A. Case No. 1997, October 2, 1969.)

Although the petition for review in the case at bar was actually received by this Court on January 28, 1989, the post office stamp on the envelope indicates that the same was mailed on January 20, 1989 or twenty nine (29) calendar days after the petitioner received the final decision of the respondent. Therefore, contrary to respondent's claim, this action has not yet prescribed.

This Court now comes to the issue on the merits. Petitioner claimed that the following expenses were disallowed in gross violation of its rights to procedural due process of law: (Petition for Review, C.T.A. Records, p. 5)

Nature of Expenses	Claimed	Allowed	Disallowed
Salaries, wages, bonuses	P 63,000.00	none	P 63,000.00
Interest and bank charges	8,599.48	P 8,599.48	none
Taxes and licenses	1,372.19	3,372.19	(2,000.00)
Gas and oil	6,803.35	none	6,803.35
Telephone, telegram and cable	746.34	none	746.34
Car repair/maintenance	12,926.10	none	12,926.10
Car insurance and registration	5,707.15	none	5,707.15
Representation and entertainment	4,226.62	none	4,226.62
Stationery, printing and supplies	646.25	646.25	none
Donations and contributions	27,207.20	4,519.40	22,687.80
Business travel	16,349.91	none	16,349.91
Accountant and auditor's fees	1,000.00	1,000.00	none
Transportation and freight	1,134.76	none	1,134.76
Depreciation	78,802.59	none	78,802.59
SSS, Medicare and EC contribution	261.70	261.70	none
Miscellaneous	4,590.60	none	4,590.60
Magazines and periodicals	249.60	none	249.60
Membership dues	340.00	none	340.00
TOTAL	P233,963.84	P18,399.02	P215,564.82

It further alleged that:

> "The aforementioned expenses claimed as deductions consisting of expenses for salaries, gas and oil, telephone, car, maintenance, etc. are all ordinary and necessary expenses commonly or normally incurred by enterprises engaged in a similar field of business. The same were all incurred and paid during the taxable year 1979. The aforesaid deductions for expenses were incurred in the course of carrying on its business as a real estate corporation. Lastly, these expenses claimed as deductions are duly supported by vouchers, and/or other documents which the examiner evidently did not bother to verify or consider altogether." (Petition for Review, C.T.A. Records, p. 7)

The applicable provision of the Tax Code is Section 30 which reads:

"Section 30. - *Deductions from Gross Income* - In computing net income, there shall be allowed as deduction -

a. *Expenses*

1. *In General.* - All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; travelling expenses while away from home in the pursuit of a trade or business, rentals or other payments required to be made as a condition to the continued use or possession, for the purpose of trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

xxx xxx xxx"

Since deductions from income are matters of legislative grace, only those expenses which are expressly provided for by law shall be allowed. Generally, however, before an expense is allowed as deduction, it must: 1) be both ordinary and necessary; 2) be paid or incurred within the taxable year; and 3) be incurred in carrying on a trade or business. (Aranas, Updated National Internal Revenue Code, 1988 Edition, p.175).

The burden of proof is on the petitioner to show that the expenses being questioned passed all the requirements for deductibility. Only then will this Court allow such deductions.

Petitioner rightly quoted in its petition (C.T.A. Records, p. 6) the meaning and application of the term "ordinary" and "necessary" as follows:

> "Expenses will ordinarily be considered necessary if the expenditure is appropriate and helpful in developing and maintaining the taxpayer's business. Obviously, under such a view, the necessity involved is not absolute or inexorable. Normally, a taxpayer will not incur an expenditure unless required or justified by the needs of the business. Proceeding on that logical assumption, the courts are slow to override the taxpayer's judgement as to the necessity for incurring the expenses. Consequently, the real difficulties in the interpretation of the terms ordinary and necessary arise not from the word necessary but from its companion word ordinary. The fact that expenses are necessary is not necessarily decisive since personal expenses can also be necessary. (Merten's Volume 4A, pp. 39-40)." (Underscoring supplied)

> "An expense will be considered ordinary if it normally occurs in connection with business similar to the one claiming the deduction. Ordinary does not imply that the payments must be habitual or normal in the sense that the taxpayer will have to make them often. A necessary expense must not be essential expense, but merely one that is proper and made in the interest of the business operation. However, an expense will not be deductible if it is necessary but not ordinary. (Michie's Federal Tax Handbook, p. 3090)." (Underscoring Supplied)

Unfortunately, petitioner was not able to prove by preponderance of evidence, expenses it claimed as proper deductions from gross income. It failed to convince this Court that the expenditures it claimed as deductions are "appropriate and helpful in developing and maintaining the taxpayer's business" or " required or justified by the needs of the business" or "proper and made in the interest of the business operation".

As correctly stated by the respondent:

> "The expenses disallowed are not ordinary and necessary expenses considering that the income of petitioner which consists mainly of rentals, dividends, interest, etc. and which are considered as passive and fixed income can be realized without the necessity of incurring the disallowed expenses.
>
> Findings of the investigating examiner disclose that the rental income, which constitutes the main bulk of petitioner's yearly income, consists of advanced rental payable every five years beginning 1973 up to the year 1977. Taking into consideration petitioner's other sources of income which are mostly passive in nature, the disallowed expenses cannot be considered as ordinary and necessary expenses deductible for taxation purposes under Section 30 of the Tax Code. (Answer, C.T.A. Records, pp. 36-37)."

Further, petitioner, for unknown reason, did not even bother to present a written formal offer of its evidence and memorandum to support its allegations. Section 34 of Rule 132 of the Rules of Court provides:

> "*Offer of evidence.-* The court shall consider no evidence which has not been formally offered. The purpose for which the evidence is offered must be specified."

The evidence deserves no consideration from the court if not formally offered in evidence (**Veran vs. Court of Tax Appeals** 157 SCRA 438; **People vs. Villapana** 161 SCRA 72; **People vs. Carino** 165 SCRA 664; **People vs. Santito Jr.** 201 SCRA 87).

There is a presumption as to the correctness and validity of the assessment (**Collector vs. Bohol Land Transportation Co.**, 107 Phil. 965). Since the presumption was not destroyed by the petitioner, this Court has no course but to affirm the same.

With regard to deficiency surtax, this Court upholds the respondent's assessment.

The pertinent provision of the National Internal Revenue Code then is Section 25 which provides:

> "Section 25. *Additional Tax on Corporations Improperly Accumulating Profits or Surplus.* - (a) *Imposition of Tax.* - If any corporation, except banks, insurance companies, or personal holding companies, whether domestic or foreign, is formed or availed or for the purpose of preventing the imposition of the tax upon its shareholders or members or the shareholders or members of another corporation, through the medium of permitting its gains and profits to accumulate instead of being divided or distributed, there is levied and assessed against such corporation, for each taxable year, a tax equal to *twenty-five per centum* of the undistributed portion of its accumulated profits or surplus which shall be in addition to the tax imposed by Section 24, and shall be computed, collected and paid in the same manner and subject to the same provisions of law, including penalties, as that tax.
>
> xxx xxx xxx
>
> (c) *Evidence determinative of purposes.* The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the tax upon its shareholders or members unless the corporation, by clear

preponderance of evidence, shall prove the contrary."

In the case of **Basilan Estates, Inc. v. Commissioner of Internal Revenue** (21 SCRA 17), the Supreme Court ruled that the taxpayer unreasonably accumulated its corporate profits based on the following circumstances:

> "1. Strong financial position of the petitioner as of December 31, 1953. Assets were P388,617.00 while the liabilities amounted to only P61,117.31 or a ratio of 6:1.
>
> 2. As of 1953, the corporation had considerable capital adequate to meet the reasonable needs of the business amounting to P327,499.69 (assets less liabilities).
>
> 3. The P200,000.00 reserved for electrification of drier and mechanization and the P50,000.00 reserved for malaria control were reverted to its surplus in 1953.
>
> 4. Withdrawal by shareholders of large sums of money as *personal loans*.
>
> 5. Investments of undistributed earnings in assets having no proximate connection with the business - as hospital building and equipment worth P59,794.72.
> 6. In 1953, with an increase of surplus amounting to P677,232.01, the capital stock was increased to P500,000.00 although there was no need for such increase."

Petitioner claimed that "(t)he foregoing circumstances do not exist in the case of petitioner Banico and Sons, Inc." (Petition for Review, C.T.A. Records, p.10) However, it conceded that "the corporation disclosed a strong financial position in the year of 1979 as shown by the fact that out of the total assets amounting to P4,356,653.00, outstanding liabilities amounted only to P704,314.00 for an asset-liability ratio of 6.1 to 1." (*Ibid.*)

Petitioner would like to impress upon this Court that there was no unreasonable accumulation of profits. It argued that (1) it had no adequate capital to meet the reasonable needs of the business; (2) its shareholders had not withdrawn large sum of money as personal loan from the corporation; and (3) it had not invested its earnings in assets having no proximate connection to the business but had invested the same in accordance with the primary and secondary purposes for which the corporation was organized.

The arguments would not stand scrutiny of this Court.

Firstly, petitioner, in a letter to respondent dated December 23, 1982 (B.I.R. Records, p. 99), claimed that corporate funds were tied up in real properties, marketable securities, and temporary investment which resulted to inadequacy of its capital to meet the reasonable needs of the business. The claim however, was belied by the financial statements submitted by the corporation. The statements showed that, in 1979, the petitioner had an increase in investment amounting to P694,531.81 computed as follows:

Marketable securities and temporary investments:

As of December 31, 1979 (BIR records, p. 27)	P2,933,930.62
Less: As of January 1, 1979 (BIR Records, p. 10)	P2,239,398.81
Increase in investment in 1979	P 694,531.81

In arguing that "the company does not have sufficient cash from which to declare cash dividends and that to sell these securities will either result in a loss or at the very least, will hamper the company's speculative activities", (B.I.R. Records, p.99) petitioner did not explain, to the satisfaction of this Court why it invested an additional P694,531.81 worth of securities.

Furthermore, contrary to petitioner's contention, it had considerable capital adequate to meet the reasonable needs of the business amounting to P3,652,338.41 (assets less liabilities).

Secondly, while it is true that no personal loans were granted to the shareholders by the petitioner, the B.I.R. Records reveal that the latter gave bonuses, salaries and wages; gasoline allowances; car repairs, insurance, registration and maintenance allowances; representation allowances; personal donations and contributions; business travels; telephone charges; etc. which, as previously discussed "not for services rendered to enhance the business of the company xxx

(H)owever, it maybe treated as distribution of dividends to the stockholders." (B.I.R. Records, p. 55)

And thirdly, petitioner failed to support its last argument. Its petition reads as follows:

> "(R)espondents evidently failed to consider the primary and secondary purposes for which the petitioner corporation was organized. Among others, the company was organized to engage in the real estate business, agriculture and in investment in marketable securities, bonds, debentures, etc. Likewise evident is that respondent's examiner also overlooked the fact as disclosed in the financial statement for the year that the petitioner corporation had under study, proposed, various projects such as construction of an ice plant and salt making project, which are all in line with the purposes for which the corporation was formed. xxx
>
> Considering the purposes for which the petitioner corporation was formed together with the various projects it was intending to undertake, it cannot be said that Banico and Sons, Inc. had allowed improper accumulation of earnings beyond the reasonable needs of its business. On the contrary, the corporation was actually in need of more funds to pursue its proposed various projects." (C.T.A. Records, pp. 8-9)

In the case of **Manila Wine Merchants, Inc. vs. Commissioner of Internal Revenue** (127 SCRA 483), the Supreme Court, quoting **Mertens**, Law of Federal Income Taxation, held:

> "A prerequisite to the imposition of the tax has been that the corporation be formed or availed of for the purpose of avoiding the income tax (or surtax) on its shareholders, or on the shareholders of any other

> corporation by permitting the earnings and profits of the corporation to accumulate instead of dividing them among or distributing them to the shareholders. If the earnings and profits were distributed, the shareholders would be required to pay an income tax thereon whereas, if the distribution were not made to them, they would incur no tax in respect to the undistributed earnings and profits of the corporation. The touchstone of liability is the purpose behind the accumulation of the income and not the consequences of the accumulation. Thus, if the failure to pay dividends is due to some other cause, such as the use of undistributed earnings and profits for the reasonable needs of the business, such purpose does not fall within the interdiction of the statute.
>
> To determine the 'reasonable needs' of the business in order to justify an accumulation of earnings, the Courts of the United States have invented the so-called 'Immediacy Test' which construed the words 'reasonable needs of the business' to mean the immediate needs of the business, and it was generally held that if the corporation did not prove an immediate need for the accumulation of the earnings and profits, the accumulation was not for the reasonable needs of the business, and the penalty tax would apply." (Underscoring supplied)

In that case, the Supreme Court affirmed the decision of this Court in finding that "the purchase of the U.S.A. Treasury bonds were in no way related to petitioner's business of importing and selling wines whisky, liquors and distilled spirits, and thus construed as an investment beyond the reasonable needs of the business." It further held that:

> "In order to determine whether profits are accumulated for the reasonable needs of the business as to avoid the surtax upon

shareholders, the controlling intention of the taxpayer is that which is manifested at the time of accumulation not subsequently declared intentions which are merely the product of afterthought. A speculative and indefinite purpose will not suffice. The mere recognition of a future problem and the discussion of possible and alternative solutions is not sufficient. Definiteness of plan coupled with action taken towards its consummation are essential." (Underscoring supplied)

In the case under consideration, petitioner, in the taxable year 1979, had an increase in investment amounting to P694,531.81. Its pleading, however, is bereft of any explanation on what type or kind of investments it entered into during the year. Petitioner was confident that by mere stating that the corporation was organized to engage in the business of investing in marketable securities, bonds or debentures, the corporation is no longer liable under Section 25 of the Tax Code.

In line with the doctrine enunciated in **Manila Wine Merchants**, case (supra), this court finds the conclusion made by the petitioner totally misplaced.

As to the proposed construction of an ice plant and salt making project, petitioner in the course of the trial, failed to present as part of its evidence, the Articles of Incorporation and the Board Resolutions to prove the approval or existence of the projects. Consequently, this Court finds the proposal speculative and indefinite. They are merely conjectures, surmises or speculations which did not pass the "immediacy test" as discussed in the above-cited case.

WHEREFORE, in view of the foregoing, the final decision of the respondent ordering petitioner to pay the amounts of P75,778.38 for deficiency income tax and P96,992.02 for deficiency surtax is hereby **AFFIRMED.**

SO ORDERED.

Quezon City, Metro Manila, September 21, 1993.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

MANUEL K. GRUBA
Associate Judge

RAMON O DE VEYRA
Associate Judge

CERTIFICATE

I hereby certify that this decision was reached after due consultation among the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge