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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

August 18, 1960

PREMIERE PRODUCTIONS, INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 532

JOSE ARAÑAS, as Commissioner
of Internal Revenue,
Respondent.

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

D E C I S I O N

This is in connection with the petitioner's claim for refund of the sum of ₱8,000.00, representing alleged overpaid income tax for 1955; and the respondent's counter-claim against the former for payment of ₱1,766.00 as deficiency income tax for the said year, plus 5% surcharge and 1% monthly interest thereon, and ₱357.73 as 5% surcharge for late payment of the second installment on the income tax.

The uncontroverted facts are as follows: Petitioner, a corporation duly organized and existing under the laws of the Philippines, is engaged in the production of movie pictures. On October 2, 1951, it petitioned the Court of Industrial Relations [Case No. 598-V (3)] to lay off 44 of its workers and laborers, who are members of the Philippine Movie Pictures Workers Association (hereof referred to as Association), on the ground that it was losing in the operation of its business. On the strength of the orders of the Industrial Court, dated November 6 and 24, 1951, the petitioner laid off the said workers and laborers.

However, the Supreme Court set aside the lay off order as premature, and directed the Court of Industrial

Relations to hear and receive the evidence offered by the workers. On August 8, 1953, the Court of Industrial Relations ordered petitioner to reinstate the laid-off workers, and, by a subsequent decision of November 7, 1953, "to pay back wages to the workers involved, from the time of their layoff, i.e., from November 8 and 24, 1951 to the date of their reinstatement."

On appeal by petitioner, the Supreme Court, in a decision dated May 31, 1955 (Premier Productions, Inc. vs. Philippine Movie Pictures Workers Association, G. R. No. L-7338), affirmed the decisions of the Industrial Court ordering the reinstatement of the laid-off workers and payment of their back wages. The decision of the Supreme Court became final on August 9, 1955.

Pursuant to a previous order, the Industrial Court Examiner computed the back wages of the laid-off workers from November 8 and 24, 1951 to July 21, 1955 to be in the amount of ₱312,000.00.

With the intention of effecting a reduction of its liability for back wages under the judgment (t.s.n. p. 13) and settlement of all its labor disputes with the Association, the petitioner, on December 3, 1956, entered into a "Compromise Agreement" with the former, binding itself to pay the Association the amount of ₱200,000.00, payable as follows: One Hundred Thousand Pesos ₱100,000.00), within fifteen (15) days from the signing of the agreement; and One Hundred Thousand Pesos (₱100,000.00), within thirty (30) days from the date of the first payment. On December 18, 1956 and January 22, 1957, the petitioner paid the amounts of ₱100,000.00 each, or the total sum of ₱200,000.00.

Meanwhile, on April 2, 1956, the petitioner, which follows the accrual method of accounting, filed its income tax return for the year 1955, reporting a taxable net income in the amount of ₱71,547.93. On the basis of this reported income, it paid income tax in two equal installments of ₱7,154.50 on May 15 and August 22, 1956, respectively.

Upon investigation of the petitioner's tax liability for 1955, the respondent determined that the former's net income from its business of producing movie pictures amounted to ₱79,021.77, and from the Premier High School ₱2,707.70 or a total of ₱81,729.47, instead of the reported sum of ₱71,547.93. Consequently, he assessed a deficiency income tax in the amount of ₱1,766.00.

On the theory that the sum of ₱200,000.00 paid to the Association constituted laid-off workers' salaries from 1951 to 1956, the petitioner apportioned equally the amount of ₱200,000.00 to five years and allocated the resulting quotient of ₱40,000.00 as back wages for the year 1955. This allocation of ₱40,000.00 is now sought to be deducted from the petitioner's returned income for 1955 in the amount of ₱71,547.93.

On December 10, 1957, the petitioner filed with the respondent Collector a claim for refund of the sum of ₱6,234.00, which after deducting the admitted 1955 deficiency income tax amounting to ₱1,766.00 represents alleged overpayment of 1955 income tax.

In view of the respondent's failure to decide the claim for refund, the petitioner, on May 15, 1958, filed before this Court the instant petition for review, seeking, among others, the refund of the sum of ₱8,000.00.

On June 27, 1958, the respondent filed his answer to the petition, interposing a counterclaim against the petitioner for the payment of the sum of ₱1,766.00 as deficiency income tax for the year 1955, plus 5% surcharge and 1% monthly interest thereon, and the amount of ₱357.73 as 5% surcharge for late payment of the second installment on the 1955 income tax.

During the hearing of the case on its merits, the petitioner admitted its liability for the payment of ₱1,766.00 as deficiency income tax for 1955, and ₱357.73 as 5% surcharge for late payment of the second installment on the 1955 income tax.

The only issues presented for our determination are the following:

> 1. Whether or not the amount of ₱40,000.00, allegedly representing the back wages of the laid-off workers for the year 1955, is deductible from petitioner's income for the same year.
>
> 2. Whether or not petitioner is liable for 5% surcharge and 1% monthly interest on the ₱1,766.00 deficiency income tax due for the year 1955.

The petitioner contends that the amount of ₱40,000.00, which is a part of the ₱200,000.00 it paid to the Association in 1956 and 1957, constitutes ordinary and necessary business expense; and the obligation to pay this amount accrued in 1955. Consequently, it is suggested that it is deductible from its income for the same year.

Upon the other hand, the respondent asserts that the petitioner's liability to pay the dismissed workers became fixed in 1956 when the compromise agreement with the Association was entered into, and, therefore, the full amount of ₱200,000.00 became deductible in the said year, not in 1955. Hence, his implied rejection of the petitioner's claim for the deduction of the allocated ₱40,000.00 from its 1955 gross income.

The basic test whether an expense item may be accrued lies in the question of whether liability is fixed. (Lucas vs. American Code Co., 280 U.S. 445, 74 L Ed 538, citing U.S. v. Anderson, 269 U.S. 422, 70 L Ed 347.) And the general rule is "that an expense accrues in the year in which all the events occur which determine the liability and fix its amount", and "if the liability is contingent and its amount unsettled, the expense does not accrue." (Canton Cotton Mills v. U.S., 94 F Supp 561, 566, citing Security Flour Mills v. Commissioner, 321 U.S. 281, 88 L ed 725.) Where the expense item is subject to a litigation, it is said to be contingent; and liability to pay become fixed only after the entry of the final judgment. (Virginia Stage Lines, Inc. v. Commissioner (1951), 16 TC 557, 562; Thorne, Neal & Co., Inc. v. Commissioner (1928), 13 BTA 490, 495, citing Brighton Mills v. Commissioner, 1 BTA 392, etc.; Lepman Bros. Co. v. Commissioner, 45 BTA 793; Highland Farms Corp. v. Commissioner, 42 BTA 1314.) But when a judgment of a lower court establishing a liability is appealed, the liability is definitely determined upon final determination and affirmation by a court of final resort

(Farmer's National Bank of Rome, N.Y. v. Commissioner of Internal Revenue, 6 BTA 1036).

In the case at bar, the liability of the petitioner to pay the back wages of its laid-off workers and laborers became fixed and definitely determined in 1955 when the decision of the Supreme Court of May 31, 1955 affirming the order of the Industrial Court became final (Farmer's National Bank of Rome, N.Y. v. Commissioner of Internal Revenue, *supra*). The liability or obligation of petitioner, which operates on an accrual method of accounting, to pay the back wages having become fixed in 1955, the whole sum of ₱200,000.00 accrued in 1955 and is deductible in that year.

The full amount of ₱200,000.00, not merely the allocated sum of ₱40,000.00, accrued and is deductible in 1955 because liability for expenses as determined by the litigation is not related to, and does not take effect as of, the time when the money ought to have been paid. (See John R. Laukenau Co. v. U.S., 46 F 2d 158.) However, since the petitioner has asked only for the deduction of ₱40,000.00 from its 1955 gross income and the corresponding readjustment of the tax for the same year, we find it unwarranted to grant more than what was prayed in its petition for review.

While the petitioner's reported net income for 1955 fell short of his actual net income for the said year, thus giving rise to a deficiency income tax of ₱1,766.00, for which it admits liability, nevertheless, the petitioner is not liable for the payment of 5% surcharge and 1% monthly interest thereon because of our finding that, in the final analysis, an overpayment of income tax for 1955 was made by the petitioner.

Upon the admission by the petitioner of its liability for payment of the counterclaimed amount of ₱1,766.00, we find the petitioner liable therefor. However, the respondent's determination of ₱357.73 cannot be sustained in full. It is to be noted that this sum of ₱357.73 represents 5% surcharge on the second installment of ₱7,154.50 which the petitioner failed to pay within the time prescribed by law. Since, as hereafter computed, the total income tax due from the petitioner for the year 1955 is ₱8,075.00, and up to the date fixed by the respondent for the payment of the second installment on the income tax, the petitioner had paid only a total of ₱7,154.50, there is therefore due from the petitioner after said date the sum of ₱920.50, on which shall be computed the surcharge of 5% (see Sec. 51 (e), Tax Code). Consequently, the petitioner is liable for the payment of ₱46.02 as 5% surcharge.

FOR THE FOREGOING CONSIDERATIONS, petitioner is entitled to the net refund of ₱6,187.98, as overpaid income tax for the year 1955, computed as follows:

Net income from production of movie pictures as per investigation	₱79,021.77	
Less: Allocated back wages ..	40,000.00	
Net income subject to tax ...	₱39,021.77	
Income tax due thereon at 20%		₱ 7,804.00

Net income from Premiere High School as per investigation .... ₱2,707.70	
Income tax due thereon at 10%	₱ 271.00
Total income tax due for 1955	₱ 8,075.00
Less: Tax paid	14,309.00
Overpayment on income tax for 1955 ..	₱ 6,234.00
Less: 5% surcharge for late payment of ₱920.50	46.02
Net refund due petitioner	₱ 6,187.98

The respondent Commissioner of Internal Revenue is hereby ordered to refund to the petitioner, Premiere Productions, Inc., the amount of ₱6,187.98. Without special pronouncement as to costs.

SO ORDERED.

Manila, August 18, 1960.

MARIANO NABLE
Presiding Judge

WE CONCUR:

AUGUSTO M. LUCIANO
Associate Judge

ROMAN M. UMALI
Associate Judge