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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

UNION GLASS AND CONTAINER CORPORATION,
Petitioner,

- versus -    C.T.A. CASE NO. 3144

THE ACTING COMMISSIONER OF INTERNAL REVENUE,
Respondent,
x - - - - - - - - - - - - - - x

7/31/89

# D E C I S I O N

This case is about an income tax deficiency assessment issued on December 6, 1976 against the petitioner in the amount of ₱20,965.27, inclusive of interest, as a result of disallowance of a claimed deduction of ₱47,301.90 representing an excess management fee payment for the taxable year ended September 30, 1974.

Petitioner protested the assessment on April 18, 1977, but which respondent denied under letter dated July 2, 1981, stating that -

> Under the Management Contract entered into by you with the CPJ Corporation on November 5, 1970, you

> shall pay a management fee of P8,000.00 a month plus 12% of your net income after taxes, bonuses and management fees. It appears, however, that you computed the 12% management fee on your net income in the audited financial statement without considering your BOI Incentives on pre-operating expenses and accelerated depreciation and other non-deductible items as shown in the auditor's reconciliation statement. The net income you used as the basis of the 12% management fee exceeded the net income after deducting the BOI Incentives on pre-operating expenses and accelerated depreciation and other non-deductible items. Accordingly, the 12% management fee you paid to CPJ Corporation cannot be claimed as a deduction in your income tax return, the same not being in accordance with the aforesaid management contract.

Hence, this appeal.

The case before Us presents no dispute as to the relatively simple material facts but the parties seem trying to get the better of each other over by a quibble as to the proper import of "net income" under the terms of the Agreement, to wit:

> CPJ shall be entitled, by way of remuneration from UGC for services under this Management Contract, to the following fees:
>
> A fixed fee of P8,000.00 a month; plus 12% of UGC's net income after taxes, bonuses and management fees.

Petitioner maintains that the phrase "net income after taxes, bonuses and management fees" upon which based the 12% contingent fee has since

1972 been consistently interpreted by the contracting parties to mean the net income figure appearing in the audited financial statements prepared by their external auditors. (Exhs. E, F, G, H, J, K, L; Testimonies of Mr. Nemesio A. Sugue, Mrs. Warrie Zenoval Totto and Mr. Luisito N. Reyes; tsn August 3, 1982, pp. 608; tsn Oct. 30, 1983, pp. 6-8, 9-10, 12-18, CTA recs.) The net income utilized for the purpose of the percentage contingent fee comports with their contractual intendment.

As before noted, however, respondent's unvarying assertion is that for purposes of assessment the net income appearing in the petitioner's income tax return for the taxable period involved, i.e., net income after deducting the BOI Incentives granted, should have been utilized for computing the 12% management fee vis a vis the net income in petitioner's audited financial statement.

We do not reach the same conclusion of respondent Commissioner.

It is perhaps hardly necessary to stress that the contract of management is the law between the parties and unless it falls sharply at odds with any legal constraint the same deserves valid cognizance. We shall be less than respecting the compelling import of the will of the contracting parties should a narrow and unvarying application of the contractually stipulated "net income" be posed. Thus stated "the computation of net income in the income tax return is simply not the "net income" contemplated by the parties. And there is no inconsistency in this at all, net income may be computed differently for different purposes, as it was computed differently for purposes of the management and for purposes of arriving at taxable income. Since the net income for purposes of the Contract is the net income appearing in petitioner's audited financial statements, respondent simply has no authority or legal basis to substitute his own computation for that of the parties to the Contract." We share petitioner's view.

We cannot help but think that the respondent has mistakenly applied the net income figure used in petitioner's tax return to a situation where what the petitioner did was merely to use permissible business judgment that better effectuate a reasonable basis for compensation in its contractual obligation. Respondent has grafted a meaning other than that conveyed by the plain and clear tenor of the terms of the Agreement. This should not however foreclose the possibility of having the legal moorings for the percentage contingent fee voided should the arrangement prove a sort of malarkey devised to evade the payment of the rightful dues, but only then may the bridge be crossed for any such deficiency tax liability. It is therefore too much of a stretch to hold petitioner straight-jacketed to the respondent's own interpretation of net income by reason thereof deny altogether any opportunity for petitioner to a serendipitous availment of allowable deduction from gross income of necessary business expenses incurred and paid during the taxable year.

Upon the records, both circumstances obtaining and relevant legal standards compel the conclusion that petitioner has proved entitlement to a favorable determination of the desired relief.

**WHEREFORE, respondent's decision appealed from is hereby set aside and cancelled. No pronouncement as to costs.**

**SO ORDERED.**

Quezon City, Metro Manila, July 31, 1989.

**ALEX Z. REYES**
Associate Judge

WE CONCUR:

**AMANTE FILLER**
Presiding Judge

(on leave)
**CONSTANTE C. ROAQUIN**
Associate Judge

**C E R T I F I C A T I O N**

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

**AMANTE FILLER**
Presiding Judge
Court of Tax Appeals