REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

M. R. ARICK,
Petitioner,

versus CTA CASE NO. 1679

COMMISSIONER OF
INTERNAL REVENUE,
Respondent.

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May 30/64

D E C I S I O N

This is an appeal of petitioner Melvin Ray Arick from a decision of respondent Commissioner of Internal Revenue dated July 14, 1965 requiring the former to pay the amounts of ₱9,621.72, ₱25,-529.30, ₱30,964.38, and ₱19,048.51 as deficiency income tax liabilities for the years 1957, 1958, 1959 and 1960, respectively, plus ₱250.00 as compromise penalty.

The petitioner, an American citizen, a mining engineer and Second Vice President of the Lepanto Consolidated Mines, filed his income tax returns for the years 1957, 1958, 1959 and 1960 declaring therein income mostly from salaries, fees and dividends. In due course, said returns were referred to examiners of the Bureau of Internal Revenue for investigation as a result of which the expenses claimed by the petitioner in his returns as deductible were disallowed by respondent.

It appears that sometime on February 16, 1956 petitioner entered into a contract with the Botolan Copper Company, Inc. represented by its President Ray C. Tuggle, to operate the company's mining properties located in Botolan, Zambales. According to the terms of the contract, petitioner will shoulder the expenses for exploration, development, mining and milling of the pay ore of the property. All expenses for work done and improvements thereon are to be reimbursed by the Botolan Copper Company, Inc.

Petitioner started operation in the mine but in 1957, because of a price drop for copper, he stopped development work in Tunnels Nos. 2 and 4. He limited his activities on this development work to maintenance and preservation so that at a future time he could undertake further development when proper economic conditions justify operations. Petitioner, however, continued work on other outcrops of the concession. During the taxable years 1957, 1958, 1959 and 1960 the mine produced no income whatsoever and the expenses incurred by petitioner in the mine for the said periods were deducted by him from his income derived from salaries, fees and dividends. These deductions which are itemized further above were disallowed by respondent. Hence, this appeal was made.

Two issues are common to all these deficiency assessments for the years 1957, 1958, 1959 and 1960 in question. First, whether the expenses for the maintenance and preservation in petitioner's mining property are ordinary and necessary expenses, incurred in the carrying on of the petitioner's business and are deductible under Section 30(a) of the Tax Code. Second, whether petitioner is subject to the compromise penalty of ₱250 imposed by respondent.

With respect to the deficiency assessments for 1957 and 1959 petitioner further raises the question of prescription. As regards the deficiency assessment for 1957 petitioner still further raises another issue, that of overpayment. With regard to the 1957 and 1958 petitioner questions the propriety of the imposition of the ½% interest.

We will first take up the deficiency assessment for 1959. (The records show that petitioner filed his income tax return for 1959 on April 18, 1960; that the deficiency assessment bearing the date of April 17, 1965 was not served by mail but by personal delivery; and that respondent's counsel admitted in open court that personal delivery to petitioner was made on April 20, 1965. It goes without saying that this deficiency assessment was out of time, more specifically, two days after the lapse of the prescriptive period.) Having reached this conclusion, it becomes unnecessary to pass upon the other issues involved in this deficiency assessment of 1959.

Next comes the deficiency assessment for 1957. It appears that petitioner filed his income tax return for said year on May 15, 1958. A deficiency assessment dated February 11, 1963 was served on petitioner on February 25, 1963. After receipt thereof petitioner filed a protest on March 18, 1963. In the said protest petitioner makes reference to the investigations conducted by respondent in connection with his tax liability for the year 1960 wherein petitioner raises issues similar to those involved in the deficiency assessment for the year 1957. In view of this protest, respondent's agent held conferences with representatives of the petitioner to hear the latter's side and referred himself to investigations and verifications of petitioner's records, books of accounts and pertinent papers. After these conferences and verifications respondent reduced the deficiency assessment from ₱41,881.76 to ₱13,698.72 in a letter dated April 17, 1965. Still unsatisfied, petitioner contested this new assessment in a letter dated April 28, 1965. Respondent thereafter reduced further the deficiency assessment from ₱13,698.72 to ₱9,621.72 in a letter of July 14, 1965. It is clear from the foregoing that the original deficiency assessment was made on time but the question now is whether the revised and final assessment of July 14, 1965 was within the prescribed period.

In the case of Collector of Internal Revenue v. Suyoc Consolidated Mining Co., et al. (104 Phil. 890), the Supreme Court held that a taxpayer who has induced the delay on the part of respondent should not be allowed to take advantage of such delay. In the present case, the record shows that conferences and verifications were made by respondent's agent because of petitioner's protest of April 28, 1965. As a matter of fact, because of these conferences and verifications respondent reduced the original deficiency assessment. Again, it appears that in petitioner's letter of protest reference was made to the investigation in connection with the petitioner's tax liability for the year 1960 wherein the legal issue raised in the protest is also raised. Because of this the consideration of the tax liability of petitioner for said years were jointly made and both were resolved in the same deficiency assessment of July 14, 1965 as may be seen in petitioner's Annex A. Under the circumstances we are constrained to say that the protest of March 18, 1963 suspended the running of the period of prescription and the said deficiency assessment was still on time.

Next comes petitioner's claim of overpayment for the year 1957. It appears in petitioner's income tax return for this year that there were sums withheld from the taxpayer's income of said year as withholding taxes. In the same return petitioner asks for the refund of ₱11,220.95 (Exh. B) as overpayment occasioned by the said withholding taxes. Respondent does not deny this overpayment nor deny the refundability of the said amount of ₱11,220.95, which more than offsets the deficiency assessment of ₱9,621.72. Consequently, there is a refundable amount of ₱1,599.23. Considering the result of this decision, this amount may just as well be considered a tax credit which may be used to offset the tax liability of the petitioner in this case.

The deficiency assessments for 1958 and 1960 involve the deductibility of the sums of ₱59,470.71 and ₱34,548.25 spent by petitioner for the mine in said years. (The parties are agreed that said expenses were made solely for maintenance and preservation while petitioner waited for economic conditions warranting the resumption of the suspended operations. Such expenses were obviously made only for maintaining and preserving an asset from which future income may be derived; petitioner was not interested in current gain from the mining property but was merely maintaining it as a foundation for the future. Expenses of this nature are not expenses for the carrying on of a business or trade,) as held in the case of Henry G. Owen v. Commissioner of Internal Revenue, 23 TC 377. In the said case the taxpayer was a temporary employee of the government living in Washington, D.C. Before his appointment as such employee he had a law office in Grand Forks, North Dakota. Contemplating return to practice later, the taxpayer maintained said office because he wanted to preserve his contacts. Passing on the deductibility of the expenses for the maintenance of taxpayer's law office, the United States Tax Court held the following:

> Although there is no direct evidence in the record in this respect, petitioner probably derived

> some benefit from his expenditures incurred to keep his office open during the years of his absence. His name on the office windows and doors served to keep his name before the public to some extent. Moreover, the existence of his law office was notice to the community that he intended to resume his practice at some future date. Perhaps we could best characterize the benefit received by petitioner from the office during 1947 as the perpetuation of his goodwill. We believe that this is what petitioner had in mind when he testified, "I wanted to keep my contacts." <u>The petitioner was, thus, attempting to maintain an asset from which his future income would be derived. He was not so much interested in current gain from his office as he was in maintaining it as a foundation for the future. These activities do not constitute carrying on a trade or business</u>. See <u>James M. Osborn</u>, 3 T.C. 603; <u>Frederick A. Purdy</u>, 12 T.C. 888. (Underscoring supplied.)

Petitioner however urges that he was in effect carrying on a business or trade because he never intended to abandon the mine. He was decided to make a paying mine out of his concession once circumstances are favorable so much so that he pursued work on other outcrops and mining claims in other areas of the concession during those years. Assuming that petitioner pursued work in other outcrops of the concession, then operational work was going thereon and the expenses for preservation form part and parcel of the operation since expenses for this purpose go hand in hand with operational work. With respect to expenses of mining ventures the authorities have the following to say:

> In Realto Min. Corp., TC Memo. Op., Dkt. 6978 (June 25, 1946), the taxpayer made no showing that the major portion of mineral production was obtained from workings other than those opened for the purpose of development or that the principal activity was production of developed ore rather than development of additional ores for mining; <u>therefore, it was not shown whether the mining claims had passed from the development stage to the producing status, and all expenditures before the producing period had to be capitalized rather than deducted as expenses</u>. (Page 233, Merten's Law of Federal Income Taxation, 1960 Revision of Volume 4, underscoring supplied.)

> On the whole, we note that except for the broad statements of the petitioner's witnesses as regards the expenses incurred, there has been no showing that the apportioned expenditures claimed as deductions were actually spent by it as "ordinary and necessary expenses for carrying on the trade or business" of the petitioner, especially considering that it was not yet engaged in the ordinary or normal mining operations.

> It should be especially remembered that during the years under review, the only "activities going on in petitioner's mines consisted of cleaning the tunnels, retimbering the underground property, erecting buildings, putting up the mill machineries, equipment, <u>maintaining these mill machineries, equipment and properties, and testing ores preparatory to full scale operations</u>" (par.

5, stipulation of facts). <u>It follows that the bulk of the expenses incurred by the petitioner were for the aforesaid purposes, which were in the character of development expenses preparatory to the engaging in the normal operations. Unless the taxpayer herein can reasonably point out which expenses or portion thereof were ordinary business expenses, the expenditures must have to be deemed capital outlays.</u> It is a rule well-recognized that -

> "if an expenditure is made to <u>attain</u> an intended output, it is properly chargeable to capital as a cost of development; if the expenditure is made to <u>maintain</u> an output, it is properly chargeable to operating expense." (Guanacevi Mining Co. vs. Commissioner of Internal Revenue, 127 F 2d 49, 51, citing Marsh Fork Coal Co. vs. Lucas, 4 Cir., 42 F 2d 83, 85, 86, and Enterprise Coal Co. vs. Philipps, D.C. Pa., 12 F Supp. 49, 50, 51 affirmed 3 Cir., 84 F 2d. 565.)

Considering that the finding of the respondent - that the payments in question were capital outlays - is presumed to be correct and the taxpayer has the burden of proving it to be erroneous (Welch v. Helvering, 1933, 290 U.S. 11, 78 L. Ed. 212), and it appearing that the petitioner has failed to show that the expenditures disallowed were in the nature of ordinary and necessary expenses rather than as capital outlays, we are constrained to hold that the disallowances were properly made. (Paracale Gumaus Consolidated Mining Company v. Jose Aranas, Collector of Internal Revenue, CTA Case No. 351; underscoring supplied.)

(In the light of the foregoing authorities the expenses in question are not expenses in the carrying on of business under the purview of Section 30(a) of the National Internal Revenue Code but are capital expenditures because petitioner's mine never reached the producing stage and the expenses for preservation and maintenance in question are part and parcel of exploration and development work in the mine.)

It would seem that the case of Kenneth C. Davis, et al (par. 166, TC Memo.; 15 TC 879) is not applicable to the case at bar. In the Davis case the taxpayer acquired a mine that was not operating, the grantor having suspended operation because of governmental war-time restriction on gold mining. All work except that for preservation and maintenance were at a standstill. The property however had income from other sources which were pursued by taxpayer. Some of the land of the concession were leased to farmers, some of the houses thereon rented, and the taxpayer sold timber of the concession. In the instant case, the property was purely a mine with no income from other sources; operations were not at a standstill since work was being pursued in other outcrops and claims of the concession. Thus, the expenses for maintenance and preservation formed part and parcel of exploration or development work in the mine.

(Petitioner urges that if his expenses were capital expenses they should be amortized. There is no evidence presented by petitioner, however, that can provide the court a basis for amortization. Petitioner having failed to comply with the burden of proof in this respect, the Court cannot grant him relief in this matter.)

In connection with the assessment for 1958, petitioner assails the imposition of the ½% interest imposed by Republic Act No. 2343 amending Section 51(2)(d) of the Tax Code because allegedly the same has no retroactive effect. This question is not a novel one having been resolved by the Supreme Court in the case of Central Azucarera Don Pedro v. Court of Tax Appeals and Commissioner of Internal Revenue (G.R. Nos. L-23236 and L-23254, May 31, 1967) wherein the Court said:

> (It appearing that the new Section 51(d) under Republic Act 2343 expressly provides that the interest on deficiency <u>shall be assessed at the same time</u> as the deficiency income tax; and that respondent Commissioner of Internal Revenue imposed and sought to collect the interest only from June 20, 1959, which was the date of effectivity of said Republic Act No. 2343; that the deficiency income taxes in question were assessed and unpaid when said Act was already in force; the Tax Court correctly held that said Section 51(d), as amended, is not being applied retroactively as contended by petitioner herein.)

(The last issue raised by petitioner is the imposition of a compromise penalty of ₱250.00. This compromise penalty is untenable in the absence of an agreement freely entered into by petitioner, as appearing in this case) (Collector of Internal Revenue v. University of Sto. Tomas, et al., G.R. Nos. L-11274 and L-11280, Nov. 28, 1958).

WHEREFORE, the appealed decision of the respondent is hereby modified, reversing the same with respect to the assessment for the years 1957 and 1959, and ordering the respondent to give the petitioner a tax credit of ₱1,599.23; affirming the said decision with respect to the assessment of 1958 and 1960 without liability for the compromise agreement. Without pronouncement as to costs.

SO ORDERED.

Quezon City, May 30, 1969.

RAMON L. AVANCEÑA
Associate Judge

I CONCUR:

ROMAN M. UMALI
Presiding Judge