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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

GINN & COMPANY,
Petitioner,

- versus -

C.T.A.
CASE NO. 674

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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D E C I S I O N

The petitioner is a corporation duly organized and existing under the laws of the state of Massachussets, U. S. A. It is duly licensed to engaged in business as publisher in the Philippines, having its principal place of business at 2021-A M. H. del Pilar, Manila. It filed its income tax return for the year 1955 reporting a gross income of ₱142,848.63 and total deductions amounting to ₱116,346.86, resulting in a net taxable income of ₱26,501.77. On the basis of said net taxable income, it paid the income tax of ₱5,300.00 at the rate of 20% prescribed in Section 24 of the National Internal Revenue Code.

Upon examination and investigation of petitioner's 1955 income tax return, respondent made a deficiency assessment against petitioner in the sum of ₱9,361.00. This deficiency assessment was brought about by the disallowance of the deduction of ₱46,802.00, consisting of:

(1) Overclaimed depreciation of furniture and fixtures ---------------- ₱ 750.00

(2) Proportionate share
of U. S. expenses -- 46,052.00
Total ---------------- ₱46,802.00

Petitioner contested the assessment, except with respect to the disallowance of overclaimed depreciation of furniture and fixtures the correctness of which is conceded by petitioner. The protest against the deficiency assessment having been overruled, petitioner paid the sum of ₱9,361.00, and, after filing the necessary written claim for refund, it instituted the instant appeal seeking the refund of ₱9,211.00, representing the income tax paid on the disallowed proportionate share of U. S. expenses in the sum of ₱46,052.00.

The sole issue raised is whether or not petitioner is entitled to claim as a deduction from its gross income in 1955 its proportionate share of the expenses of its parent company incurred in the United States in the sum of ₱46,052.00. There is no issue as regards the correctness of the amount of such proportionate expenses.

A resident foreign corporation is one not organized or created in the Philippines, but engaged in trade or business in the Philippines. The rules for determining the gross income and deductions of resident foreign corporations are the same as for nonresident alien individuals engaged in trade or business in the Philippines. (See Par. 3716, P-H Federal Tax Course, 1955.) They are taxable only on income from sources within the Philippines and are entitled to deduct from their gross income "the expenses, losses, or other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income." (Sec. 37[b], Nat. Int. Rev. Code; Sec. 152, Rev. Regs. No. 2, 39 O. G. 325.)

Section 160 of Revenue Regulations No. 2, which is a copy of Section 39.119 (b)-1 of the U. S. Income Tax Regulations 118 based upon the same law as ours, explains in detail how the "other deductions which cannot definitely be allocated to some item or class of gross income" are to be apportioned, viz:

> Section 160. APPORTIONMENT OF DEDUCTIONS.- From the items specified in section 37(a) as being derived specifically from sources within the Philippines there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any other expenses, losses or deductions which can not definitely be allocated to some item or class of gross income. The remainder shall be included in full as net income from sources within the Philippines. The ratable part is based upon the ratio of gross income from sources within the Philippines to the total gross income.
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> EXAMPLE: A nonresident alien individual whose taxable year is the calendar year, derived gross income from all sources for 1939 of ₱180,000, including therein:

Interest on bonds of a domestic corporation ------------	₱ 9,000
Dividends on stock of a domestic corporation -----------	4,000
Royalty for the use of patents within the Philippines ------------------	12,000
Gain from sale of real property located within the Philippines ---------------	11,000
Total ------	₱36,000

> that is, one-fifth of the total gross income was from sources within the Philippines. The remainder of the gross income was from sources without the Philippines, determined under section 37(c).
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> The expenses of the taxpayer for the year amounted to ₱78,000. Of these expenses the amount of ₱8,000 is properly allocated to income from sources within the Philippines and the amount of ₱40,000 is properly allocated to income from sources without the Philippines.
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> The remainder of the expenses, ₱30,000 cannot be definitely allocated to any class of income. A ratable part thereof, based upon the relation of gross income from sources within the Philippines to the total gross income, shall be deducted in computing net income from sources within the Philippines. Thus, there are deducted from the ₱36,000 of gross income from sources within the Philippines expenses amounting to ₱14,000 (representing ₱8,000 properly apportioned to the income from sources within the Philippines and ₱6,000, a ratable part [one-fifth] of the expenses which could not be allocated to any item or class of gross income). The remainder, ₱22,000, is the net income from sources within the Philippines.

It is, therefore, clear that expenditures made by a foreign corporation in conducting its business are deductible in computing its taxable income from sources within the Philippines only when allocable to the production of income from sources within the Philippines or where a ratable part of general expenditures is apportioned to income from sources within the Philippines. (See The Fajardo Sugar Co. of Porto Rico, 20 BTA 980, cited in Par. 16,625, P-H Federal Taxes, 1955.) The contention of respondent that the deduction of a proportionate home office expenses of petitioner cannot be allowed as a deduction because "in the very nature of things, it is impossible to check and verify said expenses" is without merit. The fact that it is difficult for respondent to check and verify the alleged expenses because the records concerning the same are kept in a foreign country is no justification for the denial of the deduction, otherwise the law would be rendered meaningless. It is, however, essential that there be proof that a portion of such home office expenses is allocable to income from sources within the Philippines.

In this case, it has been sufficiently proven that a portion of petitioner's home office expenses during the year under review is allocable to income from Philippine sources. (Exhs. C and C-1.) As correctly stated by counsel for petitioner:

> "In its business of publishing books, the home office of the petitioner in the United States performs entirely the editorial work on the books published in the Philippines. (t.s.n. p. 11) The home office also takes charge of securing permission to reprint copyrighted works of various authors throughout the world, which phase of the work could not be done in the Philippines. (t.s.n. pp. 16-17) All illustrations, specifications and format of the books are likewise done abroad. (t.s.n. pp. 23-25) Except for the actual physical process of printing the books in the Philippines, it is the petitioner's head office that performs all the functions relative to the preparation of a book for publication.
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> "In addition to the technical assistance rendered by the home office to its Philippine branch, it also takes direct charge and supervises the accounts of the local operation. Monthly financial reports are submitted to the home office which advises the branch office as to the proper procedure of recording its accounts. (t.s.n. pp. 28-29) All general policies are dictated by the home office, both on the business and administrative part of its activities in the Philippines. The local office also participates in the

Pension Plan and the Profit Sharing Trust Plan of the company of which the employees in the Philippines are members. This plan is entirely financed by the company and all benefits accrue to the members. (t.s.n. pp. 29-30, Exhibit I and I-1) In addition to such pension plan, the home office insures its employees in the Philippines at its own expense (t.s.n. pp. 30-31)." (Page 2, Memorandum for the Petitioner.)

Assuming that a portion of home office expenses are allocable to income from sources within the Philippines, it is argued on behalf of respondent that the expenses in question are not ordinary and necessary expenses within the meaning of Section 30(a) of the Revenue Code. Among such expenses are the general and administrative expenses, advertising expenses and the expenses in connection with profit sharing and pension plans. Sections 65 and 118 of Revenue Regulations No. 2, quoted below, sufficiently answer respondent's contention.

Section 65. BUSINESS EXPENSES.- Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. Among the items included in business expenses are management expenses, commissions, labor, supplies, incidental repairs, operating expenses of transportation, equipment used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business, advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. A taxpayer is entitled to deduct the necessary expenses paid in carrying on his business from his gross income from whatever source.

Section 118. PAYMENTS TO EMPLOYEES'

PENSION TRUSTS.- An employer who adopts or has adopted a reasonable pension plan, actuarially sound, and who establishes, or has established, and maintains a pension trust for the payment of reasonable pensions to his employees shall be allowed to deduct from gross income reasonable amounts paid to such trust, in accordance with the pension plan (including any reasonable amendment thereof), as follows:

(a) If the plan contemplates the payment to the trust, in advance of the time when pensions are granted, of amounts to provide for future pensions payments, then (1) reasonable amounts paid to the trust during the taxable year representing the pension liability applicable to such year, determined in accordance with the plan, shall be allowed as a deduction for such year as an ordinary and necessary business expense, and in addition (2) one-tenth of a reasonable amount transferred or paid to the trust during the taxable year to cover in whole or in part the pension liability applicable to the years prior to the taxable year, or so transferred or paid to place the trust on a sound financial basis, shall be allowed as a deduction for the taxable year and for each of the nine succeeding taxable years.

(b) If the plan does not contemplate the payment to the trust, in advance of the time when pensions are granted, of amounts to provide for future pension payments, then (1) reasonable amounts paid to the trust during the taxable year representing the present value of the expected future payments in respect of pensions granted to employees retired during the taxable year shall be allowed as a deduction for such year as an ordinary and necessary business expense, and in additon (2) one-tenth of a reasonable amount transferred or paid to the trust during the taxable year to cover in whole or in part the present value of the expected future payments in respect of pensions granted to employees retired prior to the taxable year, or so transferred or paid to place the trust on a sound financial basis, shall be allowed as a deduction for the taxable year and for each of the nine succeeding taxable years.

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IN VIEW OF THE FOREGOING, we find petitioner's claim for refund in order. Accordingly, respondent is ordered to refund to petitioner the sum of ₱9,211.00, without pronouncement as to costs.

SO ORDERED.

Manila, May 21, 1963.

ROMAN M. UMALI
Associate Judge

I CONCUR:

MARIANO NABLE
Presiding Judge

Associate Judge AUGUSTO M. LUCIANO did not take part.