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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

ATLAS CONSOLIDATED MINING
& DEVELOPMENT COMPANY,
Petitioner

versus

C. T. A. CASE NO. 1312

Oct 25/66

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

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

D E C I S I O N

This is an appeal from respondent's decision wherein petitioner was assessed ₱39,646.82 as 1958 deficiency income tax, inclusive of interest, computed as follows:

1 9 5 8

Total Net income for the year 1958		₱1,968,898.27
Net income corresponding to taxable period April 1 to Dec. 31, 1958 3/4 of ₱1,968,898.27		1,476,673.70
Add: Corresponding portion of the discrepancies: Total discrepancy -	₱159,993.91	
Three-fourth (3/4) thereof		119,995.43
Net income per investigation		₱1,596,669.13
Tax due thereon		₱ 439,067.00
Less: Amount already assessed		405,468.00
B a l a n c e		₱ 33,599.00
Add: ½% monthly interest from 6-20-59 to 6-20-62		6,047.82
TOTAL AMOUNT DUE & COLLECTIBLE		₱ 39,646.82

(See Annex "C," Amended Petition, p. 45, CTA Records.)

In the amended petition for review dated July 7, 1964, petitioner disputed and questioned respondent's disallowances of deductions from petitioner's gross income of the following items, namely:

Transfer agents fee . . .	₱ 59,477.42
Stockholders relation service fee	25,523.14
U. S. stock listing expenses	8,326.70
Suit expenses	6,666.65
Provision for contingencies	60,000.00
T O T A L . . .	₱159,993.91

(Exhs. "C" & "8" in relation to Exhs. "A" & "4".)

In the original petition for review dated December 26, 1962, petitioner disputed and questioned respondent's decision wherein petitioner was assessed ₱546,295.16 and ₱125,493.96, or a total of ₱761,789.12, as 1957 and 1958 deficiency income tax, respectively, inclusive of interest. The 1957 deficiency income tax assessment against petitioner was predicated on the theory that it was not entitled to exemption from income tax under the provisions of Republic Act No. 909.

On October 26, 1962, the Secretary of Finance ruled that the exemption from income tax granted to mining companies by Section 4 of Republic Act No. 909 refers to income derived from all mines and not limited to income from gold mines alone. Consequently, the 1957 deficiency income tax assessment of ₱546,295.16 issued by respondent against petitioner was withdrawn and cancelled and the 1958 deficiency income tax assessment of ₱215,493.96 was reduced to ₱39,646.82, *supra*.

The first question, therefore, at issue in this case is whether or not the deductions disallowed by respondent from petitioner's gross income in 1958 were valid and legal under Section 30 of the National Internal Revenue Code, the pertinent provisions of which read as follows:

> "SEC. 30. Deductions from gross income. - In computing net income there shall be allowed as deductions -
>
> (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, x x x"

Before resolving the legal question at issue, respondent raised for the first time in his memorandum a prejudicial question, that is, whether or not the business expenses deducted from petitioner's gross income in 1958 may be allowed in the absence of proof of payment. Respondent emphatically contends that, in the absence of convincing and satisfactory evidence of payment, the deductions claimed by petitioner in its 1958 income tax return cannot be sustained even on that score alone.

Petitioner admitted that it failed to adduce satisfactory and convincing evidence of payment of the deductions claimed in its 1958 income tax return because respondent did not raise that question of fact in his pleadings or even in the report of the investigating examiner and/or letters of demand and assessment notices of respondent which gave rise to this appeal. Petitioner contends that it went to trial and finally submitted this case for decision on the assumption that, inasmuch as the fact of payment was never raised as a vital issue by respondent in his answer to the petition for review, the issue is limited to a question of law - whether or not the expenses deducted by petitioner from its gross income in 1958 are sanctioned by Section 30 of the National Internal Revenue Code.

Petitioner's contention is well taken. A careful review of the memorandum-report of the investigating examiners dated February 28, 1961 (BIR rec. pp. 150-153, Folder I), the 2nd Indorsement of Supervising Revenue Examiner R. D. Atienza dated May 5, 1964 (BIR rec. pp. 421-422, Folder III), the memorandum of the Chief, Litigation Division, to the Commissioner of Internal Revenue dated December 17, 1963 (BIR rec. pp. 398-403, Folder III), and the answer of respondent to petitioner's amended petition for review, dated September 29, 1964, particularly paragraph 6(b) thereof, strongly supports petitioner's contention that respondent never controverted the fact of payment of the claimed deductions. Consequently, as the question of payment of the expenses claimed by petitioner as deduction from gross income was never questioned by respondent before, he cannot raise the question for the first time in his memorandum, to the surprise and disadvantage of the adverse party. It is a fundamental rule in procedure that the purpose of the pleadings is to simplify the issues between party litigants, prevent surprises, and avoid undue advantages.

Accordingly, we hold that respondent, in an appeal, cannot be allowed to adopt a theory distinct and different from that he has pursued before as shown by the BIR records and the answer to the amended petition for review (See Agoncillo v. Javier, 38 Phil. 424; American Express v. Natividad, 46 Phil. 207; Balceta, et al. v. Espe, et al., C. A. - G. R. No. 16115-R, April 5, 1957; and Commissioner of Customs v. Valencia, 100 Phil. 172-173, October 31, 1956).

We shall dispose of the disputed items of deduction in the order in which they were treated in respondent's memorandum. For income tax purposes, an expense is allowed as a deduction from gross income if it satisfies the following requirements:

1. The expense must be both ordinary and necessary;

2. The expense must be paid or incurred within the taxable year; and

3. The expense must be incurred in carrying on a trade or business.

Considering the basic requirements enumerated above, we will now resolve the deductibility from gross income of the following expenses of petitioner, namely:

(a) Transfer Agents Fee of ₱59,477.42.

Petitioner engaged the services of transfer agents and registrars in the Philippines and the United States. In 1958, petitioner spent for said services here and abroad the amount of ₱60,266.62 which was paid to the following:

<u>Philippine</u> stock transfer agent:

(1) Stock Transfer Service, Inc., Manila . . . . ₱16,798.50

<u>U. S.</u> stock transfer agencies:

(1) Bankers Trust Co.) (2) First National City Bank of) New York) (3) Bank of America)	43,468.12
T O T A L . . .	₱60,266.62

(BIR rec. pp. 161-162, Folder I)

The said transfer agents and registrars render services to the petitioner by keeping books and records wherein are recorded transactions involving transfers of petitioner's stock from one stockholder to another. They also kept an up-to-date record of petitioner's stockholders here and abroad. Ordinarily, they sent notices of meetings, proxy forms and stock dividends to petitioner's stockholders. For these services, petitioner paid the total sum of ₱60,266.62 to its transfer agents, the deduction of which it justifies as ordinary and necessary expenses under Section 30(a)(1) of the National Internal Revenue Code, <u>supra</u>. Moreover, petitioner cited as authority a ruling of the U. S. Internal Revenue Service which reads as follows:

> "The fees paid by the taxpayer corporation during its fiscal year to its registrar and transfer agent in connection with the transfer of its capital stock are ordinary and necessary business expenses under section 23(a) of the Revenue Act of 1928, and constitute allowable deductions from gross income.

"A question is presented relative to the deductibility of fees paid by the Company during its fiscal year ended on June 30, 1930, to its registrar and transfer agent in connection with the registration and transfer of its capital stock.

"When stock issued by the taxpayer was listed on the New York Stock Exchange it was necessary to appoint a registrar and transfer agent to take care of registration and transfer of the taxpayer's capital stock in accordance with the requirements in that respect. The expenditures in connection with the registration and transfer of the capital stock were not incurred as the result of the organization, re-organization, or recapitalization of the corporation, but were the usual recurring charges which the maintenance of a correct record of the company's stockholders. It is stated that, in accordance with the decision rendered by the United States Board of Tax Appeals in the case of Dome Mines, Ltd. (20 BTA, 377), the amounts so claimed as deductions were disallowed by the examining officer on the theory that such expenditures were not incurred in carrying on the taxpayer's business within the meaning of section 23(a) of the Revenue Act of 1928.

"The above-mentioned decision pertains exclusively to the deductibility of an amount expended with respect to the listing of Dome Mines, Ltd., stock on the New York Stock Exchange at or about the time of the formation of that corporation.

x x x x x x

"Such listing fee is, of course, paid but once and is usually paid at or about the time of the organization or reorganization of the corporation. After the stock is so listed, the fees paid to the registrar and transfer agent are annual recurring charges required in maintaining an up-to-date record of the stockholders. Although the taxpayer corporation is formed primarily to engage in a particular business, the corporate organization must be maintained in order to vote on various matters in connection with the business, which require the sanction of the stockholders. For such purpose, it is obvious that the proper records showing the names and addresses of the stockholders must be maintained. While in the case of a corporation, the stock of which is not listed on an exchange, such records are ordinarily maintained by the corporation itself, there does not appear to be any reason for making a distinction in that respect where a corporation, whose stock is listed on the exchange, employs a separate registrar and transfer agent to maintain such records.

"It is held, therefore, that the fees paid by the taxpayer corporation during its fiscal year to its registrar and transfer agent in connection with the transfer of its capital stock are ordinary and necessary business expenses under section 23(a) of the Revenue Act of 1928, and therefore constitute allowable deductions from the gross income." (I.T. 2582, Cum. Bull. X-2, Int. Rev. Bull., July-Dec. 1931, pp. 129-130.)

In the case at bar, we hold that the disallowed deduction of ₱59,477.42 paid by petitioner to the Stock Transfer Service, Inc., Bankers Trust Co., First National City Bank of New York and Bank of America, domestic and foreign stock transfer agents, is both ordinary and necessary expense because the shares of stock of petitioner are listed and traded in the Manila Stock Exchange and the American Stock Exchange.

(b) Stockholders Relation Service Fee of ₱25,523.14.

Petitioner deducted ₱26,523.14 from its 1958 gross income as expenses paid for services of a public relations firm, P. K. Macker & Co., a reputable public relations consultant in New York City. Of the said amount only ₱1,000.00 was allowed as a deduction while ₱25,523.14 was disallowed on the ground that the expense was not incurred in carrying on the trade or business of petitioner.

Petitioner contends that the expense is ordinary and necessary in order "to compete with other corporations also interested in the investment market there (U. S.)" (p. 11, Petitioner's Memorandum). The information about petitioner "was given out and played up on the mass communication media of which the witness (the public relations consultant) was an expert and resulted in full subscription of the additional shares issued by petitioner" (pp. 11-12, Petitioner's Memorandum).

It is to be noted that on December 27, 1957, petitioner increased its capital stock from ₱15,000,000.00 to ₱18,325,000.00. It is claimed that petitioner's shares of stock worth ₱3,325,000.00 were sold in the United States because of the services rendered by the said public relations consultant. It is clear, therefore, that this item of deduction was spent for the acquisition of additional capital. Consequently, said expense of ₱25,523.14 is not deductible from petitioner's gross income because expenses relating to recapitalization and reorganization of a corporation (Missouri-Kansas Pipe Line Co. v. Commissioner of Internal Revenue, 148 F. /2d/ 460; Skenandoa Rayon Corp. v. Commissioner of Internal Revenue, 122 F. /2d/ 268, cert. denied 314 U. S. 6961, the cost of obtaining stock subscriptions (Simons Co., 8 B. T. A. 631), promotion expenses (Beneficial Industrial Loan Corp. v. Handy, 92 F. /2d/ 74), and commissions or fees paid for the sale of stock after reorganization (Protective Finance Corp., 23 B. T. A. 308) are capital expenditures. (Underlining ours)

Moreover, the expenditure of ₱25,523.14 to the P. Macker & Co., a public relations consultant, as compensation for services in carrying on the selling campaign in an effort to sell petitioner's additional capital stock of ₱3,325,000.00 is not an ordinary expense in accordance with the decision of the Board of Tax Appeals (U. S.) in the case of Harrisburg Hospital, Inc., v. Commissioner of Internal Revenue (15 B. T. A. 1016-1017) to which we concur. Said decision reads in part as follows:

> "The expenditure of $4,243.90 to the Edward J. McCormick Co. as compensation for services in carrying on the selling campaign in an effort to sell petitioner's capital stock is not an ordinary expense. (See C. H. Lilly Co., 2 B. T. A. 1058; Emmerson Manufacturing Co., 3 B. T. A. 932; Simmons Co., 8 B. T. A. 631).
>
> "x x x The services performed were in connection with capital and the expenditures were capital expenditures. We see no legal distinction between the payment of commissions for the sale of stock and the payment for services in selling stock or undertaking to sell it. In either case the payment is in connection with the acquisition of capital. x x x"

(c) U. S. Listing Expenses of ₱8,326.70

Petitioner deducted from its 1958 gross income the sum of ₱3,987.30 for the listing of its shares in the American Stock Exchange. However, respondent disallowed the deduction of ₱8,326.70 instead of ₱3,987.30.

Petitioner's shares of stock have been originally listed in the American Stock Exchange since 1956 in order that they could be sold through the said exchange to the American market. For the listing of the shares, an annual fee is charged by the Exchange. In 1956, 1957 and 1958, petitioner paid to the American Stock Exchange the sums of ₱40,326.61, ₱18,559.80 and ₱3,987.30, respectively.

Respondent contends that the amount paid by petitioner to the said exchange in 1958 is not deductible from gross income because the expense for the listing of its shares is not ordinary and necessary, citing as authority the decision of the Board of Tax Appeals in the case of Domes Mines Ltd. v. Commissioner of Internal Revenue, 20 B. T. A. 377.

We do not subscribe to the view of respondent. The amount spent for the listing of shares in the American Stock Exchange should be allowed as a deduction from petitioner's gross income in 1958, conformably with the ruling of the U. S. Tax Court in the case of The Chesapeake Corporation of Virginia v. Commissioner of Internal Revenue, dated October 10, 1951 (17 T. C. 674-675), which we approve. The pertinent portion of said decision reads as follows:

> "It appears that the listing of the petitioner's stock on the Exchange took place prior to the taxable year. In each year thereafter, including the year 1945,

> the petitioner paid to the Exchange an amount to cover what the Exchange designates as a 'Continuing Annual Fee for Stock.' The amount of such fee is payable annually for 15 years and is calculated on the number of shares outstanding and listed on the anniversary date of the admission of the stock issue to deal on the Exchange.
>
> "In support of his disallowance of the Stock Exchange fee, counsel for the respondent cites cases which he contends have held that the cost of listing a stock issue is not a deductible expense. Dome Mines, Ltd., 20 B. T. A. 368. We are not here concerned with a listing fee, which is an item that is paid but once, and any benefits flowing therefrom presumably last over a period of years. Such a payment has been ruled to be a capital expenditure. I. T. 1836, II-2 C. B. 158. The item here in dispute is an annually recurring cost for the annual maintenance of the listing. Therefore, even on the assumption that it is a capital expenditure, it is one made for a capital item which is exhausted within one year and, consequently, an amount equivalent to the amount of the expenditure is deductible in the year in which it is made. We hold that the respondent erred in disallowing the fee paid to the New York Stock Exchange."

(d) <u>Suit Expenses of ₱6,666.65</u>.

Petitioner also deducted from its 1958 gross income the amount of ₱23,333.30 as attorneys' fees and expenses of litigation in connection with Civil Case No. 30566 of the Court of First Instance of Manila, where Edythe F. Heyman, Lester Osterman and Abraham & Co., minority stockholders of Mindanao Mother Lodes, Inc., instituted an action against petitioner corporation, A. Soriano y Cia, Andres Soriano, Manuel Lim, et al. asking that the sale of the Toledo mining properties made by Mindanao Mother Lodes, Inc. to petitioner herein be declared null and void and that Atlas Consolidated Mining & Development Corporation be ordered to restore said properties to Mindanao; the defendants Atlas, Andres Soriano and A. Soriano y Cia. be ordered to render an accounting of all the monies, properties and profits received by them by reason of the purchase of the Toledo mining properties; the defendants in the said case be ordered to pay plaintiffs moral damages; and the defendants in the said case be ordered to pay plaintiffs' counsel attorney's fees (Exh. "F," pp. 68 and 73, CTA rec.). Of the amount deducted, respondent disallowed ₱6,666.65 although the investigating revenue examiner recommended the disallowance of ₱13,333.30 (Exhs. "D-1," "E-4," "A," & "1"). The disallowance of ₱6,666.65 was predicated on the ground that the said amount was a capital expenditure and, therefore, not deductible from petitioner's 1958 gross income under Section 121 of Revenue Regulations No. 2, otherwise known as the Income Tax Regulations, which provides in brief as follows:

> "SEC. 121. Capital expenditures. - x x x The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. x x x"

A careful examination of the pleadings of plaintiffs and defendants in the said court case (Exhs. "F" and "G") undoubtedly shows that the litigation expenses were incurred in defense of title to the Toledo mining properties purchased by Atlas Consolidated Mining & Development Corporation from Mindanao Lode Mines, Inc. Consequently, said expenses are not deductible from petitioner's gross income, in line with the decision of the U. S. Tax Court in the case of Safety Tube Corp. v. Commissioner of Internal Revenue (8 T. C. 762-763, April 2, 1947) which held, in part, as follows:

> "x x x It is well settled that legal expenditures incurred in defense or protection of title are capital in nature and nondeductible." (Bowers v. Lumpkin, 140 Fed. /2d/ 927; certiorari denied, 322 U. S. 88; Jones' Estate v. Commissioner, 127 Fed. /2d/ 231; Brawner v. Burnet, 63 Fed. /2d/ 129; Murphy Oil Co. v. Burnet, 55 Fed. /2d/ 17; affirmed in another point, 287 U. S. 299; underscoring supplied.)

Again, in the case of Coughlin v. Commissioner of Internal Revenue (3 T. C. 422), the U. S. Tax Court held, among others, as follows:

> "It has long since been established, under section 23(a), that expenditures in defense of title to property constitute a part of the cost of the property, and are not deductible as expenses. The regulations have consistently so held, and court decisions have sustained the regulations. Morgan Jones Estate, 43 B. T. A. 691; aff'd. (C. C. A., 5th Cir.), 127 Fed. (2d) 231. That case concerned the deductibility of expenses incurred in a suit to remove a cloud upon the title caused by a forged mineral deed. The Circuit Court of Appeals for the Fifth Circuit said, in part:
>
> > 'It is immaterial that this petitioner was required to defend the title long after the property was first acquired, and at a time when he reasonably might have expected to incur no additional expense. The nature of a suit to cancel a cloud upon title to real estate remains constant whether the action be prosecuted

> at the time, or long after, the acquisition of title. It is a contest involving the ownership of the property itself, and the title to property held for profit is a capital asset.'" (Underscoring supplied)

Petitioner, however, contends that the action brought against it was for accounting of income and that it made counterclaim for damages and, therefore, the expenses incurred in connection therewith are deductible from its gross income. Suffice it to say that demand for accounting of income included in the litigation was a corrolary to the determination of title (Safety Tube Corp. v. Commissioner) <u>supra</u> and that the counterclaim for damages was dependent upon and incidental to successful defense of title.

> Where petitioners made counterclaim for accounting and treble damages in action brought that petitioners' patents were void and invalid, counterclaim relief was dependent upon and incidental to successful defense of title so that expenses of litigation were capital expenditures not deductible as ordinary and necessary business expenses. (Urquhart v. Commissioner of Internal Revenue, 20 T. C. 944, Sept. 9, 1953.)

The disallowance, therefore, of the deduction of ₱6,666.65 from petitioner's 1958 gross income is justified.

(e) <u>Provision for Contingencies of ₱60,000.00</u>.

Respondent added this amount to petitioner's net income for 1958, contending that it was not included in the gross income reported in petitioner's income tax return. The records, however, show that the provision for contingencies of ₱60,000.00 was taken up by petitioner in its Statement of Income and Earned Surplus (Exh. "E-2," p. 187, Folder I, BIR rec.) as a deduction from gross income and was listed as one of the items under the heading "Other Expenses." The total amount of these expenses as shown in the above-mentioned statement was ₱1,195,136.17. However, in its 1958 income tax return (Exh. "D," p. 192, Folder I, BIR rec.), petitioner reduced the total of said other expenses to ₱1,135,136.17, or lesser by ₱60,000.00 than that appearing in its Statement of Income and Earned Surplus. This amount was arrived at because the certified public accountant, who prepared petitioner's income tax return, deducted the ₱60,000.00 from the other expense column (See worksheet, Exh. "E-5," CTA rec., p. 64). In effect, the said amount was added back to petitioner's income with the result that an increase of ₱60,000.00 was included in petitioner's taxable income. Consequently, petitioner has not deducted the provision for contingencies of ₱60,000.00 from its 1958 taxable income.

(f) ½% Monthly Interest on Deficiency Income Tax from 6-20-59 to 6-20-62.

The imposition of the ½% monthly interest on the deficiency income tax was disputed by petitioner in its amended petition (See Annex A and Par. 8(e) of Amended

Petition, pp. 40-43, CTA rec.). However, in counsel's memorandum dated January 6, 1966, petitioner did not pursue its protest against the inclusion of interest in respondent's income tax assessment, which may be considered an abandonment of its objection to the imposition thereof. Moreover, the imposition of the said ½% monthly interest on the deficiency income tax under Section 51(e) (2) of the Tax Code is in accord with our decision in previous cases (Heald Lumber Co. v. Padilla, et al., CTA Case No. 1222, March 23, 1964; Central Azucarera Don Pedro v. Commissioner of Internal Revenue, CTA Case No. 1273, June 15, 1964; and Central Azucarera Don Pedro v. Commissioner of Internal Revenue, CTA Case No. 1278, June 29, 1964).

(g) Reserve for Bodega Losses of ₱66,204.00.

The amount of ₱66,204.00 was claimed for the first time by respondent in his memorandum as subject to income tax because said amount was not included in the income tax assessment appealed from. This new issue cannot legally be considered by this Court because it involves a change of theory distinct and different from that followed by respondent previously (Agoncillo v. Javier; American Express v. Natividad; Balceta v. Espe; and Commissioner v. Valencia, supra). Moreover, a review of the evidences of record (Exhs. "D," "E-2" & "E-5") shows that the amount in question was not also deducted from petitioner's 1958 taxable income inasmuch as it was treated in the same manner as the ₱60,000.00 provision for contingencies.

Under the facts, circumstances and applicable law in this case, the unallowable deductions from petitioner's gross income in 1958 amounted to ₱32,189.79, itemized and computed as follows:

Stockholders relation service fee	₱25,523.14
Suit and litigation expense	6,666.65
T O T A L	₱32,189.79

As the exemption of petitioner from the payment of corporate income tax under Section 4, Republic Act No. 909, was good only up to the 1st quarter of 1958 ending on March 31 of the same year, only three-fourth (3/4) of the net taxable income of petitioner is subject to income tax, computed as follows:

1958

Total net income for 1958		₱1,968,898.27
Net income corresponding to taxable period April 1 to Dec. 31, 1958, 3/4 of ₱1,968,898.27		1,476,673.70
Add: 3/4 of promotion fees of ₱25,523.14	₱19,142.35	
Litigation Expense	6,666.65	25,809.00
Net income per decision		₱1,502,482.70
Tax due thereon		₱ 412,695.00
Less: Amount already assessed		405,468.00
DEFICIENCY INCOME TAX DUE		₱ 7,227.00
Add: ½% monthly interest from 6-20-59 to 6-20-62 (18%). . .		1,300.89
TOTAL AMOUNT DUE AND COLLECTIBLE		₱ 8,526.11

IN VIEW OF THE FOREGOING CONSIDERATIONS, the decision appealed from is hereby modified and petitioner is hereby ordered to pay respondent or his duly authorized collection agent the sum of ₱8,526.11 as 1958 deficiency income tax and interest. If the said deficiency income tax is not paid in full within thirty (30) days from the date this decision becomes final and executory, petitioner shall pay a surcharge of 5% of the unpaid amount, plus interest thereon at the rate of 1% a month until paid, subject to the limitation provided in Section 51 of the Revenue Code.

SO ORDERED.

Quezon City, October 25, 1966.

Estanislao R. Alvarez
ESTANISLAO R. ALVAREZ
Associate Judge

WE CONCUR:

R. M. Umali
ROMAN M. UMALI
Presiding Judge

Ramon L. Avanceña
RAMON L. AVANCEÑA
Associate Judge