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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

BRITISH TRADERS' INSURANCE CO., LTD.,
Petitioner,

- versus -

January 30, 1962

C.T.A. CASE NO. 683

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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D E C I S I O N

This is an appeal filed by the petitioner, British Traders' Insurance Co., Ltd., from the decision of respondent Commissioner of Internal Revenue assessing against and demanding from it withholding income taxes for the years 1954 and 1955 in the amounts of ₱73,643.75 and ₱73,391.25, respectively, or the total sum of ₱147,035.00, inclusive of the 25% surcharge and the compromise penalties in the total amount of ₱600.00. (Exhs. 11 & 13, pp. 30-31; & 37, BIR rec.)

The petitioner herein is a foreign insurance company organized under the laws of Hongkong. Since 1907, it has been authorized to transact business in the Philippines. (Exhs. A, A-1, A-2, & B, pp. 16-21, CTA rec.) In 1954 and 1955, the petitioner ceded by way of reinsurance a part of its direct insurances underwritten in the Philippines to nonresident foreign reinsurers. Said reinsurance cessions of insurances underwritten in the Philippines were made pursuant to treaties of reinsurance which were negotiated and executed by petitioner's London

Office with various nonresident foreign corporations, outside the Philippines. (Exhs. E, E-1, F, F-1, G, G-1, G-2, H, H-1, & H-2, pp. 22-124, CTA rec.)

In the examination and investigation of petitioner's income tax returns and books of accounts for the years 1954 and 1955, the respondent found that the petitioner did not report the ceded premiums as income of the nonresident foreign reinsurers and withhold the income tax due thereon. On the basis of this finding, and considering the fact that the petitioner did not also report for taxation said ceded premiums in its own income tax returns for the years under review, the respondent, in a letter dated April 21, 1959, demanded from the petitioner the payment of withholding income taxes in the total amount of ₱147,035.00, computed as follows:

For the year 1954:

Total premiums ceded abroad	₱244,480.35
Tax due thereon at 24%	₱ 58,675.00
25% surcharge	14,668.75
Compromise for non-filing of return	300.00
TOTAL AMOUNT DUE	₱ 73,643.75

For the year 1955:

Total premiums ceded abroad	₱243,636.19
Tax due thereon at 24%	₱ 58,473.00
25% surcharge	14,618.25
Compromise for non-filing of return	300.00
TOTAL AMOUNT DUE	₱ 73,391.25

(See Exh. 11, pp. 30-31, BIR rec.)

The petitioner, in a letter dated May 18, 1959, protested against the assessments for withholding income taxes, and for the reasons stated therein, requested for its reconsideration and withdrawal. (Exh. T, also marked as Exh. 12, pp. 34-35, BIR rec.) However, the respondent, in his letter of June 30, 1959, denied petitioner's request for reconsideration and reiterated his demand for the payment of the total amount of ₱147,035.00 representing withholding income taxes for the years 1954 and 1955, inclusive of the 25% surcharge and compromise penalties. (Exh. 13, p. 37, BIR rec.) Hence, this appeal.

The issues to be resolved in this case are the following:

1. Whether or not the premiums earned from insurances directly underwritten by the petitioner in the Philippines, which the petitioner ceded and remitted, thru its London office, to nonresident foreign insurance companies, pursuant to treaties of reinsurance executed abroad between petitioner's London office and the nonresident foreign reinsurers, are subject to the withholding income tax at source prescribed in Section 54 of the Tax Code; and

2. Whether or not the petitioner is liable for the payment of the 25% surcharge on the withholding income tax assessments.

Section 54 of the National Internal Revenue Code provides as follows:

"Sec. 54. Payment of corporation income tax at source.- In the case of foreign corporations subject to taxation under this Title not engaged in trade or business within the Philippines and not having any office or place of business therein, there shall be deducted and withheld at the source in the same manner and upon the same items as is provided in section fifty-three a tax equal to twenty-four per centum (now 30%) thereof, and such tax shall be returned and paid in the same manner and subject to the same conditions as provided in that section. (Underscoring and words in parenthesis supplied.)

And the pertinent provisions of Section 53 of the Tax Code read as follows:

"Sec. 53. Withholding of tax at source.-

x x x x

(b) Nonresident aliens.- All persons, corporations and general copartnerships (compañias colectivas), in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, receivers, conservators, fiduciaries, employers, and all officers and employees of the Government of the Philippines having the control, receipt, custody, disposal, or payment of interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income of any nonresident alien individual, not engaged in trade or business within the Philippines and not having any office or place of business therein shall x x x deduct and withhold from such annual or periodical gains, profits, and income a tax equal to twelve per centum (now 20%) thereof. x x x" (Words in parenthesis supplied.)

With regard to the first issue, the petitioner contends that the withholding tax assessments on the reinsurances ceded to nonresident foreign reinsurers pursuant to the treaties of reinsurance executed abroad are devoid of legal basis for the following reasons:

(1) The reinsurance premiums ceded under the treaties of reinsurance executed abroad do not constitute income from sources within the Philippines; and

(2) The reinsurance cessions are not fixed or determinable, and therefore, are not subject to withholding income tax.

On the first issue, we wish to state that we have already ruled in the case of Alexander Howden & Co., Ltd., (CTA-Manila Civil Case No. 22848, Nov. 24, 1961) the facts of which are substantially similar to the instant case, that the premiums earned from insurances underwritten in the Philippines, but ceded and remitted to nonresident foreign reinsurance companies, pursuant to reinsurance agreements executed and signed abroad, are subject to the withholding-of-income tax-at-source provisions of the Tax Code. Hence, in answer to the arguments of the petitioner in the present case, it shall suffice to quote pertinent portions from our decision in the Howden case, *supra*.

With regard to the claim that the reinsurance premiums ceded under the treaties of reinsurance executed abroad do not constitute income from sources within the Philippines, we held that:

> "This last claim of the plaintiffs does not consider the true and real nature of the reinsurance premiums in question. In the instant case, it is admitted that the plaintiffs received from the Commonwealth Insurance Co., a domestic corporation, the reinsurance premiums on risks originally insured with the said local company. (Par. 3, STIFACTS.) In other words, the reinsurance premiums were

taken from the premiums earned by the Commonwealth Insurance Co. from its insurance business conducted in the Philippines, and then ceded to the plaintiffs herein. Hence, the reinsurance premiums were derived from the Philippines. The word 'source' can convey only one idea, that of origin, and the origin of the said reinsurance premiums was the Philippines. (Manila Gas Corp. vs. Collector of Internal Revenue, 62 Phil. 895.)

"There can be no question that from the insurance business directly underwritten in the Philippines by the Commonwealth Insurance Co., all the premiums, including those ceded or transferred to the plaintiffs herein, were earned from sources within the Philippines. Undoubtedly, if the Commonwealth Insurance Co. did not cede or transfer to the plaintiffs, by way of reinsurance part of its earned premiums, the said ceded premiums would have been subjected to the payment of income tax and the Commonwealth Insurance Co. would have been required to pay the same. In short, the reinsurance premiums represent the share of the plaintiffs in the premiums earned from Philippine sources, and the plaintiffs should be required to pay the corresponding Philippine income tax on the same.

"Furthermore, the activity that actually produced the ceded premiums was the underwriting of risks or insurances in the Philippines, and this particular activity enjoyed the protection of the government. Therefore, it is but fair and right that the said reinsurance premiums be levied upon to defray part of the expenses of the Philippine Government. (Mertens, Law of Federal Income Taxation, Vol. 8, Chap. 45, Sec. 45.27, pp. 63-64.)"

As to the argument that the reinsurance cessions are not fixed or determinable, and therefore are not subject to withholding income tax, we held in the same Howden case, supra, that:

"We also find this contention of the plaintiffs to be untenable. Note that Section 53 (b) of the Tax Code which is quoted above specifically mentions 'premiums' as among those subject to withholding income tax. Ubi Lex Non Distinguit, Nec Nos Dis-

> tinguere Debemus. When the law does not distinguish, there is no justification to make any distinction. Applying this well settled principle to the present case, we believe and so hold that this term 'premiums' as used in said Section 53 (b) includes reinsurance premiums. (See Mertens, Law of Federal Income Taxation, Vol. 8, Chap. 44, Sec. 44.48, p. 170 quoted supra.) Therefore, the reinsurance premiums which were paid to the plaintiffs are subject to withholding income tax.
>
> "Granting, arguendo that the word 'premiums' does not include reinsurance premiums, it is our opinion that the said reinsurance premiums, although not fixed annual income, may be classified as determinable periodical income."

We find in the case at bar no valid and strong reason to depart from our rulings in the Howden case, supra. Hence, we hold that the premiums earned from insurances directly underwritten by the petitioner in the Philippines, which the petitioner ceded and remitted, thru its London office, to nonresident foreign insurance companies, pursuant to treaties of reinsurance executed abroad between petitioner's London office and the nonresident foreign reinsurers, are subject to the withholding income tax at source prescribed in Section 54 of the National Internal Revenue Code.

Having held that the reinsurance premiums in question are subject to withholding income tax, let us now come to the issue of whether or not the petitioner is liable for the payment of the 25% surcharge on the withholding income tax assessments.

It is admitted that the petitioner did not file the required withholding income tax returns for the years 1954 and 1955, nor did it withhold any income tax on the reinsurance premiums during the years in question. (p. 25, Memorandum for Petitioner, pp. 266-293, CTA rec.) However, it is likewise admitted that during those years, the rulings established by the respondent Commissioner of Internal Revenue were to the effect that reinsurance premiums ceded and remitted to non-resident foreign insurance companies are not subject to income tax, and because of these BIR rulings, the petitioner did not file any withholding income tax returns, nor withheld and pay any income tax on the reinsurance premiums in controversy for the years 1954 and 1955. (pp. 13-14, Memorandum for Respondent, pp. 327-341, CTA rec.)

In the case of Collector of Internal Revenue vs. Batangas Transportation Co., G.R. No. L-9692, January 6, 1958, (54 OG 6724) the Supreme Court, interpreting and applying Section 72 of the Tax Code, ruled that "where the failure to file an income tax return x x x was due to a reasonable cause, such as an honest belief based on the advice of its attorneys and accountants, a penalty in the form of a surcharge should not be imposed and collected." In the light of this doctrine, we are of the opinion and so hold that in the case at bar, the imposition of the twenty-five per cent (25%) surcharge for failure to file the withholding income tax returns for the years 1954 and 1955 is not warranted considering that said failure was due to a "reasonable cause," based not only on the advice of its attorneys and accountants, but also on the then prevailing rulings of the respondent Commissioner of Internal Revenue.

As to the compromise penalties for the non-filing of returns in the total amount of ₱600.00 which the respondent seeks to collect from the petitioner, it shall suffice to state that the Supreme Court has repeatedly held that it is clearly illegal and unauthorized for the Commissioner of Internal Revenue to arbitrarily impose and collect compromise penalties. (Collector of Internal Revenue vs. Bautista, G. R. No. L-12250, May 27, 1959; Collector of Internal Revenue vs. U.S.T., G. R. No. L-11274, November 28, 1958.)

WHEREFORE, in view of the foregoing considerations, petitioner British Traders' Insurance Co., Ltd., is hereby ordered to pay the Commissioner of Internal Revenue the total amount of ₱117,148.00 as withholding income tax for the years 1954 and 1955, within thirty (30) days from the date this decision becomes final.

If any amount of the tax is not paid within the time prescribed above, there shall be collected a surcharge of 5% of the tax unpaid, plus interest at the rate of 1% a month from the date of delinquency to the date of payment, provided that the maximum amount that may be collected as interest shall not exceed the amount corresponding to a period of three (3) years. With costs against the petitioner.

SO ORDERED.

Manila, January 30, 1962.

AUGUSTO M. LUCIANO
Associate Judge

I concur:

MARIANO NABLE
Presiding Judge

Associate Judge ROMAN M. UMALI dissents in a separate opinion.

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DISSENTING OPINION

I dissent for the same reasons stated in my dissenting opinion in Alexander Howden & Co., Ltd. v. Collector of Internal Revenue, Manila Civil Case No. 22848, decided by this Court on November 24, 1961, which, for convenience, is reproduced below in full:

> I dissent. It is my opinion that the reinsurance premiums received by petitioners under the circumstances stated in the majority opinion are not subject to the Philippine income tax.
>
> There is no dispute that the petitioners are foreign corporations not doing business in the Philippines. Under Section 24 of the National Internal Revenue Code foreign corporations not doing business in the Philippines are subject to income tax only on incomes from sources within the Philippines. The terms "income from sources within the Philippines" and "income from sources without the Philippines" are defined in Section 37.
>
> The long established and unbroken rule in the United States, from which our Income Tax Law was patterned, is that insurance premiums paid by a U. S. corporation to a foreign corporation not doing business and having no office or agent therein, under a contract of insurance made in a foreign country, are not taxable in the United States.

"Insurance premiums paid by a domestic corporation to a foreign corporation having no office or agent in U.S., under a contract of insurance made in a foreign country, are not taxable in U. S. A. R. R. 723, I-1 CB 113." (Vol. 3 CCH Standard Federal Tax Reporter (1954), Par. 902.05, page 27,-036.)

The rule is stated in PH Federal Taxes as follows:

"A selling agent of a corporation was required to insure it against any loss upon sales made through him. An amount paid him by the corporation, pursuant to a contract with him, in reimbursement of the premiums paid, constitutes a deductible expense. These premiums, paid to a foreign corporation having no office or agent in the United States, under a contract of insurance made in a foreign country, are held not to be income to the foreign corporation from sources within the United States. (A.R.R. 723, C.B. June, 1922, p. 113.)" (Vol. 2, PH Federal Taxes (1955), par. 16,299, page 16,-240; underscoring ours.)

Applying the above doctrine, which to my mind is decisive, to the case at bar, the conclusion is inevitable that the reinsurance premiums paid by a domestic corporation to the foreign corporations, petitioners herein, are not subject to the Philippine income tax because they are not incomes from sources within the Philippines.

It is contended, however, that the reinsurance premiums in question are incomes from sources within the Philippines because they were "taken from the premiums earned by the Commonwealth Insurance Co. from its insurance business conducted in the Philippines, and then ceded to the plaintiffs herein" and, therefore, "the reinsurance premiums were derived from the Philippines." In other words, it is the position of the Government that said reinsurance premiums are incomes from sources within the Philippines because they were paid to foreign corporations by a domestic corporation out of premiums earned by the latter from its business in the Philippines. This is not a correct appraisal of the doctrine in regard to the situs of insurance or reinsurance premiums for purposes of the income tax. To quote again, for convenient reference, the prevailing rule in the United States:

> "These premiums, paid to a foreign corporation having no office or agent in the United States, under a contract of insurance made in a foreign country, <u>are held not to be income to the foreign corporation from sources within the United States</u>." (A.R.R. 723, C.B. June, 1922, p. 113, <u>supra</u>; emphasis supplied.)

It is clear from the foregoing statement of the rule that the situs of insurance or reinsurance premiums for purposes of the income tax is determined not by the residence of the payor or the source of the funds out of which the payment is made or by the place where the risk is situated <u>but by the place where the contract of insurance or reinsurance is made</u>. In the instant case the contracts of reinsurance were made in a foreign country.

It is also alleged that under Section 53 of the Revenue Code, in relation to Section 54, foreign corporations not doing business in the Philippines are subject to the withholding tax on "premiums" received by them. This is so because, according to the Government, the law specifically mentions "premiums" as among those subject to the withholding tax, and because the law does not distinguish, there is no justification to make any distinction. This argument overlooks the fact that under the law foreign corporations not doing business in the Philippines are expressly taxed only on incomes from sources within the Philippines, so that the word "premiums" mentioned in Section 53 can not refer to premiums earned by foreign corporations from sources without the Philippines. And it is well settled that insurance or reinsurance premiums received by such foreign corporations from a domestic corporation by virtue of insurance or reinsurance contracts made in a foreign country can not be considered incomes from sources within the Philippines.

"A foreign insurance company having no business in the United States received premium payments from a United States broker through a foreign broker; such payments are neither fixed nor determinable income to the foreign insurance company." (I.T. 1359, CB June 1922, p. 292, cited in Vol. 2 PH Federal Taxes, Par. 18,-274, page 18,226.)

The doctrine that premiums received from a domestic corporation by a foreign corporation not engaged in business in the Philippines by virtue of insurance contracts made abroad are not taxable here had been the prevailing view in this jurisdiction until recently when respondent sought to overrule the same. We quote from an opinion of former Secretary of Justice Jose Abad Santos:

"The rule in these cases, therefore, is that premiums paid to nonresident foreign insurance companies thru insurance brokers abroad, not being 'fixed or determinable', are not subject to the withholding provisions of the Income Tax Law. In view whereof, I am of the opinion that the refund . . . may be legally made." (Opinion No. 186, s. of 1939; see also B.I.R. ruling of Dec. 8, 1953, Annex A of Petition for Review.)

Respondent now seeks to overrule the doctrine solely on the ground that-

". . . if the risk is situated in the Philippines, either the owner of the risk or the reinsuring company should withhold the premium tax even if the contract of insurance was executed outside the Philippines. Consequently, the ruling of this Office dated December 8, 1953 is hereby revoked." (See Exh. H.)

Respondent's view is that premiums received by a foreign insurance company not engaged in business in the Philippines is subject to the withholding tax notwithstanding that the contract of insurance or reinsurance is made abroad, provided the risk is situated here. As already stated above, the correct rule is that the situs of insurance premiums is determined by the place where the insurance contract is made and not by the place where the risk is situated or by the place of payment. In a case involving the taxability of the income derived by a non-resident foreign corporation from the sale in a foreign country of shares of stock issued by a Philippine corporation, respondent also sought to overrule the doctrine that the situs of the income, for income tax purposes, is determined by the place where the contract of sale was made by expressing the opinion that the situs is determined not by the place of sale but by the place where the property represented by the shares of stock are situated. Respondent's view was overruled. (See Anglo-California National Bank v. Coll. of Int. Rev., C.T.A. No. 280, May 10, 1957, affd. in G. R. No. L-12476, Jan. 29, 1960.) It is believed that respondent has again misunderstood the distinction between the situs of the property or the risk, for purposes other than income tax,[1] and the situs of the income, or the insurance premium, for purposes of the income tax.

I vote to reverse the decision appealed from.

ROMAN M. UMALI
Associate Judge

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[1] See, for instance, Sec. 122 of the Revenue Code, providing that the situs of property for purposes of the estate, inheritance and gift tax purposes is determined primarily by the place where the property is situated.