Library

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

CENTRAL AZUCARERA DE BAIS,
Petitioner,

versus C. T. A. CASE NO. 183

THE COLLECTOR OF INTERNAL
REVENUE,
Respondent.
x - - - - - - - - - - - - x

May 31, 1963

DECISION

This is an appeal from a decision of respondent assessing against and demanding from petitioner the payment of the sum of ₱56,480.00 as deficiency income tax for the fiscal year ending October 31, 1951. Of this sum, ₱25,814.00 has been settled and the only remaining amount now being questioned in this appeal is ₱30,666.00.

The undisputed facts have been fairly stated by respondent in his memorandum thus:

"x x x x x

"On January 21, 1952, petitioner filed its income tax return, which was made on the basis of accrued income and expenses, declaring therein a total net income amounting to ₱1,062,089.58. (Exh. A; Exh. 1, p. 18, BIR rec.) Among the deductions claimed by petitioner in the said return, but disallowed by the respondent, are as follows:

1. Uncollectible war damage claim for war losses ... ₱104,410.24

2. Interest expense applicable to 1945-1949 (Amount was charged to Surplus Account) 77,284.00

3. Rentals - applicable to 1945-1949 (Amount was charged to Surplus Account) .... ₱ 24,831.32

4. Rectification Balance (Miscellaneous expenses as per return) - prior year expenses 10,703.98

(See Exh. 2, p. 21, Exh. 1-A, pp. 13-17, BIR rec.)
Consequently, after crediting the amount of ₱269,476.50 as income tax previously paid by the petitioner on the basis of the return (Exh. A), respondent assessed and demanded from the former the payment of the sum of ₱56,480.00 as deficiency income tax (Exh. 2, p. 21; Exh. 3, p. 22, BIR rec.), which arose from the aforementioned disallowances.

"In his letter dated January 20, 1955 (pp. 29-40, BIR Rec.), counsel for the petitioner, for reasons stated therein, requested the cancellation and withdrawal of the assessment, which was, however, denied by the respondent in his letter dated February 2, 1955 (Exh. 4, pp. 42-44, BIR Rec.). Subsequently, counsel for the petitioner, in his letter dated April 18, 1955 (pp. 52-58, BIR Rec.), again requested the cancellation and withdrawal of the assessment. This second request was also denied by the respondent, in his letter dated July 28, 1955 (Exh. 5, pp. 65-68, BIR Rec.). Not satisfied with the said decision of the respondent, petitioner elevated the case to this Honorable Court by filing a petition for review.

"Thereafter, counsel for the petitioner, in his letters dated September 23, 1957 (p. 89, BIR Rec.) and September 19, 1958 (pp. 92-93, BIR Rec.), informed respondent that petitioner was willing to pay the the deficiency income tax corresponding to the disallowance of the war losses mentioned above in the amount of ₱104,410.24. As computed by the Chief, Income Tax Division, Bureau of Internal Revenue, the deficiency income tax corresponding to the said disallowance of war losses amounted to ₱25,814.00 (p. 90, BIR Rec.)

"Previously, or more specifically on February 25, 1956, however, the respondent granted the petitioner a tax credit of ₱19,299.11 representing overpaid income tax for 1949, which was applied as partial settlement of the sum of ₱25,814.00 (p. 90, BIR Rec.) Accordingly, in his letter dated January 11, 1961 (pp. 98-99, BIR Rec.), respondent demanded from petitioner the payment of the sum of ₱6,514.89, still due from the latter. The aforesaid balance of ₱6,514.89 was paid by petitioner under Invoice No. 018944 on March 8, 1961. (p. 100, BIR Rec.) In other words, the amount of ₱25,814.00 as income tax corresponding to the disallowed war losses has been fully settled.

"Of the sum of ₱56,480.00 originally demanded from petitioner, the balance of ₱30,666.00 corresponds to the other deductions mentioned above which were disallowed by respondent and which are still being disputed by petitioner in this action."

The only issue in this case is whether or not the deductions claimed by petitioner in its income tax return for the fiscal year ended October 31, 1951, viz: (1) Interest expense applicable to 1945-1949 in the amount of ₱77,284.00; (2) rentals applicable to 1945-1949 in the amount of ₱24,831.32; and (3) rectification balance (miscellaneous expenses) in the total amount of ₱10,703.98, which brought about the deficiency income tax assessment in the amount of ₱30,-666.00, are deductible from its gross income for 1951.

Generally, in all these three (3) items claimed as deduction in its income tax return, petitioner contends that these expenses accrued or were incurred and are deductible from the gross income during the fiscal year ended October 31, 1951. On the other hand, respondent insists that these expenses were incurred during the years prior to the fiscal year 1951 and therefore are not deductible from the gross income of petitioner during the fiscal year in question.

We shall treat each item of deduction claimed, but disallowed by respondent, separately.

1. INTEREST EXPENSE - ₱77,284.00. This first item represents interests corresponding to the years 1945-1949 paid on the "current account" maintained by petitioner with the Cia. Gral. de Tabacos de Filipinas (Tabacalera, for short). Petitioner claims that it was only in the fiscal year ended October 31, 1951 that these interests were finally determined for the reasons that the reconstitution of the evidences of loans and payments, which were allegedly destroyed during the last war, the resolution of the courts on the questions of validity of transactions involving Japanese war notes and the post war equivalent of the fiat currency, and the determination of the outstanding

balance of the current account took place only during the said fiscal year. On the other hand, respondent contends that the interest expenses in question accrued during the prior years and, therefore, are not deductible from the gross income of the fiscal year ended October 31, 1951.

The general rule on accrual is that items of deductions are "allowed under the accrual method only where the facts demonstrated the existence of a definite liability to pay an established or ascertainable amount", except that accrual and deduction of liability may arise where there is an "imminent, recognized liability to pay a sum susceptible of reasonable ascertainment as to amount x x x". (Mertens, Law of Federal Income Taxation, Vol. 2, Sec. 12.61 pp. 128, 131-132; see also CCH, Vol. 3, Secs. 2907.02 & 2907.021.) Moreover, an expense liability in order to be accrued must be "fixed and absolute"; and "a liability does not accrue as long as it remains contingent". (Brown v. Helvering, 291 US 200-201.)

The evidence shows that the interests in question ripened into a definite liability only upon the determination of the outstanding balance of the current account between petitioner and Tabacalera. Under the circumstances, this determination had to wait until the lost evidences of loans and payments were reconstituted and the validity of the post war equivalent of the Japanese war notes in genuine Philippine currency was established in the first of a series of decisions of the Supreme Court. Petitioner had no knowledge of all the facts upon which to base the accrual of interests for the years prior to the fiscal year 1951; and for want of it, interest cannot be said to have accrued in those years (Bear Film Co., 18 TC 354; Lucas vs. American Code Co., 280 U. S. 445). Having been uncontestably determined during the fiscal year ended October 31, 1951, the interest expense of ₱77,284.00 is deductible from the gross income of said fiscal year.]

2. RENTALS OF ₱24,831.32. - This second item represents the rentals paid on December 12, 1950 by petitioner to the Government on leases of public lands (Exhs. 6 to 6-E; 7 to 7-1; 8 to 8-A-1; 12-12-D) for the years from May, 1945 to May, 1950 (See Exhs. 10, 13 & 14). Petitioner claims that it is deductible from its gross income for the fiscal year ended October 31, 1951 when the rental bills were presented to it for payment, for until said presentation the amount of rentals was uncertain.

We disagree with petitioner's claims because the documentary evidence clearly shows that the liability to pay the rentals from year to year in specific amounts is fixed and determined in the lease contracts with the Government. Hence, the rental expense at bar is deductible during the (previous) years when liability therefor became fixed. (U.S. v. Woodward, 256 U.S. 632; Hoffman vs. U. S. 53 F 2d 282, 288), not in the fiscal year ended October 31, 1951 (See Weisbecker, 18 BTA 766).

But petitioner maintains that although it has knowledge of such leases with the Government, "all the records of the Government and the company (petitioner) were disrupted" by the war. However, it did not "inquire into the records of the government as to the existence of the copies of these (lease) contracts" (pp. 26-27, t.s.n.). Petitioner's omission to so inquire should militate against its claim for rental deduction in a subsequent year.

3. RECTIFICATION BALANCE (MISCELLANEOUS EXPENSES) OF ₱10,703.95. This aggregate amount of ₱10,703.95 consists of the following various items of expenses or charges:

(1) Arriendo terrenos en luks desde Mayo a Octubre 1950 ..	₱2,643.90
(2) Haberes de licencia de J. Zabaljauregui de Agosto a Octubre 1950	375.00
(3) Arriendo Mangle Manjuyod desde 1945 a 1950	305.00

We disagree with petitioner's claims because the documentary evidence clearly shows that the liability to pay the rentals from year to year in specific amounts is fixed and determined in the lease contracts with the Government. Hence, the rental expense at bar is deductible during the (previous) years when liability therefor became fixed. (U.S. v. Woodward, 256 U.S. 632; Hoffman vs. U. S. 53 F 2d 282, 288), not in the fiscal year ended October 31, 1951 (See Weisbecker, 18 BTA 766).

But petitioner maintains that although it has knowledge of such leases with the Government, "all the records of the Government and the company (petitioner) were disrupted" by the war. However, it did not "inquire into the records of the government as to the existence of the copies of these (lease) contracts" (pp. 26-27, t.s.n.). Petitioner's omission to so inquire should militate against its claim for rental deduction in a subsequent year.

3. <u>RECTIFICATION BALANCE (MISCELLANEOUS EXPENSES) OF ₱10,703.95</u>. This aggregate amount of ₱10,703.95 consists of the following various items of expenses or charges:

(1) Arriendo terrenos en luka desde Mayo a Octubre 1950 ..	₱2,643.00
(2) Haberes de licencia de J. Zabaljauregui de Agosto a Octubre 1950	375.00
(3) Arriendo Mangle Manjuyod desde 1945 a 1950	305.00

(4)	Diferencia entre calculo y liquidacion definitiva de los 11,935 pps embarcados por V Titan bank en 1950 . . .	₱ 2,448.55
(5)	1% de mayor participacion cosecha 1950 de Julio Garcia ..	94.83
(6)	Sueldos de R. Kohler del año 1950	2,576.50
(7)	Impuesto especifico merma alcohol	2,026.35
(8)	Compensating tax sobre 5 arados comprados al Foreign Liquidation Fund	568.45
(9)	1% de mayor participacion cosecha 1950 de Anfore Hnos. .	114.50
(10)	Haberes de S. Macawili correspondiente a 10 dias en 1946	20.00
(11)	Cancelacion intereses desde 1946 a 1950 de la cuenta herederos de F. Cabello	686.75
(12)	Reclamacion deferencias fletes de azucar de exportacion embarcados en 1949	1,918.86
		₱13,778.69

And after deducting the total sum of ₱3,074.71, representing credited (recovered) expenditures, from the total disallowed rectification balance or miscellaneous expenses, there remains only the sum of ₱10,703.98 now in dispute (See Exh. 4, pp. 42-44, BIR rec.).

It is the contention of petitioner that the net amount of ₱10,703.98 is the result of liquidation of accounts which were uncertain prior to the fiscal year ended October 31, 1951. Since the final settlement of these unsettled accounts was effected only during said fiscal year, it is suggested that the various items of expenses or charges accrued during the same fiscal year.

We will consider fragmented items of similar nature at the same time.

For the same reason heretofore stated that petitioner's claim for deduction of ₱24,831.32 was properly disallowed, we rule that items (1) and (3) of Rectification Balance (Miscellaneous Expenses), which represent rentals for the periods from October, 1950, and from 1945 to 1950, respectively, are not deductible from the gross income for the fiscal year ended October 31, 1951. These items should have been deducted in the years of accrual which were prior to said fiscal year.

Items (2) and (6) in the amounts of ₱375.00 and ₱2,576.50, which are undisputedly expenditures incurred by petitioner's office in Barcelona, Spain, in 1950, but which were known to petitioner only in the fiscal year ended October 31, 1951, should be allowed as deduction in the said fiscal year, as it was in that year they became fixed and definite, and not in 1950 during which petitioner had no knowledge of the facts upon which accrual could have been based (Bear Film Co., *ibid*).

The liability to pay items (4) and (12) in the respective amounts of ₱2,448.55 and ₱1,918.86, representing payments (liquidation) for shipping charges on exported sugar, became fixed and definite only in the fiscal year 1951 when the statements of charges were presented by foreign shipping companies to petitioner for payment or discharge. Hence, these expenses are deductible in that fiscal year 1951.

Items (5) and (9) in the amounts of ₱94.83 and ₱114.50 represent adjustments or corrections in the sugar participations of Julio Garcia and Anfore Hermanos, respectively. These corrections or adjustments having been made in the fiscal year ended October 31, 1951, they are deductible in the said fiscal year.

Items (7) and (8) in the amounts of ₱2,026.35 and ₱568.45 constitute specific and compensating taxes, respectively, which the Bureau of Internal Revenue assessed and collected during the fiscal year ended October 31, 1951. As the liability to pay these items in specific amounts was ascertained by petitioner only when it paid the taxes in 1951, these expenses are deductible in the fiscal year ended October 31, 1951.

Item (10) in the amount of ₱20.00 represents salary of I. Macawili in 1946, of which petitioner had knowledge in 1946. Hence, it should have been accrued in 1946 and not in the fiscal year ended October 31, 1951 when Macawili claimed and received it. If compensation has accrued (that is, services were known to have been rendered and salary was due) in one year, it is not deductible in a leter year when payment is made (See Hoskins Lumber Co., 3 BTA 846; T. Kohn & Son, 3 BTA 1075).

Lastly, item (11) in the amount of ₱686.75, which resulted from the cancellation of interests which took place only during the fiscal year ended October 31, 1951, is deductible only in said fiscal year because liability therefor was ascertained only in that year.

In line with the foregoing opinion, the deficiency income tax liability of petitioner for the fiscal year 1951 is ₱5,895.00 computed as follows:

Net income per return ------------		₱1,062,089.58
Add: Disallowed rentals --	₱24,831.32	
Miscellaneous expenses -	2,968.90	27,800.22
Net income ---------------------		₱1,089,889.80
Tax due thereon:		
Total tax due -------------		275,371.00
Less: Tax already paid -----		269,476.00
Deficiency tax due ---------		₱ 5,895.00

WHEREFORE, the decision of respondent should be as it is hereby, modified. Petitioner is hereby ordered to pay respondent the sum of ₱5,895.00, as deficiency income tax for the fiscal year ended October 31, 1951, plus the statutory delinquency penalties thereon. Without pronouncement as to costs.

SO ORDERED.

Manila, May 31, 1963.

ROMAN M. UMALI
Associate Judge

I CONCUR:

AUGUSTO M. LUCIANO
Associate Judge