REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

Aug. 29/69

HOSPITAL DE SAN JUAN DE DIOS, INC.,
Petitioner,

versus

CTA CASE NO. 1693

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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

D E C I S I O N

This is an appeal from the decision of respondent assessing petitioner for the sums of ₱899.91, ₱6,467.67, ₱3,777.48 and ₱5,707.35 as deficiency income taxes for the respective years from 1952 to 1955, inclusive of the ½% monthly interest from June 20, 1959 to November 8, 1960, or a total sum of ₱16,852.41, and ₱640.00, as real estate dealer's fixed tax, also for the years 1952 to 1955, inclusive of the administrative penalties for late payment.

The facts are not in dispute, the parties having submitted the following stipulation of facts:

> 1. That the petitioner is a charitable, non-stock, non-profit corporation, duly organized and existing under the laws of the Philippines

with business address at 46 Roxas Boulevard, Pasay City, while the respondent is the duly appointed Commissioner of Internal Revenue with offices at the Finance Building, Ermita, Manila, duly vested with authority to act as such for the government of the Republic of the Philippines;

2. That during the years 1952 to 1955, inclusive, the petitioner derived income from the following sources:

(a) income derived from the operation of the hospital and nursing school;

(b) real estate transactions;

(c) income from rentals;

(d) interest income;

(e) dividends;

(f) income from an aliquot part of building acquired by lease; and

(g) miscellaneous income.

3. That the income derived from the operation of the hospital and the nursing school are exempt from income tax, while the rest of petitioner's income are subject to income tax, pursuant to the provisions of Section 27(e) of the National Internal Revenue Code, as amended;

4. That the income tax returns of the petitioner for the years 1952 to 1955, inclusive, were examined by agents of the respondent and, in a letter of the respondent dated January 15, 1959, the latter assessed and demanded from the petitioner the payment of the aggregate amount of ₱51,462.00 as deficiency income taxes for the years 1952 to 1955, details of which are as follows:

1 9 5 2

Net income per return		₱ 10,739.96
Add: Underdeclared income as per analysis of taxable income and allowable expenses hereto attached		5,015.93
Net income per investigation . . .		₱ 15,755.89
Tax due thereon		₱ 3,151.00
Less: Amount already assessed and paid		2,148.00
Balance		₱ 1,003.00
Add: 50% surcharge		502.00
DEFICIENCY TAX DUE		₱ 1,505.00

1 9 5 3

Net Loss per return		(₱ 23,654.06)
Add: Unallowable deductions and additional income:		
Net loss per return disallowed . . .	₱ 23,654.06	
Net income as per investigation. .	35,130.65	58,784.71
Net income per investigation		₱ 35,130.65
Tax due thereon		₱ 7,026.00
Add: 50% surcharge.		3,513.00
DEFICIENCY TAX DUE		₱ 10,539.00

1 9 5 4

Net loss per return		(₱ 6,732.44)
Unallowable deductions & additional income:		
Net loss per return disallowed: . . .	₱6,732.44	
Net income taxable per enclosed working papers . . .	45,394.77	52,127.21
Net income per investigation		₱ 45,394.77
Tax due thereon		₱ 9,079.00
Add: 50% surcharge		₱ 4,540.00
DEFICIENCY TAX DUE		₱ 13,619.00

1 9 5 5

Net income per return		₱ 7,397.18
Unallowable deductions & additional income:		
Underdeclared income:		

Net taxable income as per analysis of taxable income and allowable deductions	₱93,387.69	
Less: Net income already declared as per return	7,397.18	85,990.51
Net income per investigation		₱93,387.69
Tax due thereon		₱18,678.00
Less: Amount already assessed and paid		1,479.00
Balance		₱17,199.00
Add: 50% surcharge.		8,600.00
DEFICIENCY TAX DUE		₱25,799.00

5. That in addition to the aggregate amount of ₱51,462.00 demanded in the abovementioned letter of respondent, dated January 15, 1959, the further sum of ₱640.00 as real estate dealer's fixed tax for the years 1952 to 1955, plus administrative penalties for late payment, was likewise demanded by respondent from petitioner;

6. That on March 2, 1959, the petitioner filed its letter dated February 28, 1959 with the respondent protesting against the deficiency income tax assessments for the years 1952 to 1955, inclusive, and requesting for their cancellation and withdrawal;

7. That in a letter dated November 8, 1960, the respondent informed the petitioner that the original assessment in the aggregate amount of ₱51,462.00 for the period from 1952 to 1955, inclusive, was reduced to an aggregate amount of ₱16,852.41, details of which are as follows:

<u>1 9 5 2</u>

Taxable Income:		
Real Estate Income		₱ 26,176.33
Income from Maysilo Bldg.. . .		610.00
Interest Income		4,221.37
Dividends - 25% of	₱12,182.40	3,045.60
Aliquot part of Bldg. acquired by lease.		4,500.00
Miscellaneous Income		213.68
T O T A L		₱ 38,767.18

T O T A L	₱ 38,767.18
Less: Allowable deductions	23,872.45
Net taxable income	₱ 14,894.73
Tax due thereon	2,979.00
Less: Amount already paid	2,148.00
B a l a n c e	₱ 831.00
Add: ½% monthly interest from June 20, 1959 to November 8, 1960	68.91
TOTAL AMOUNT DUE	₱ 899.91

1 9 5 3

Taxable Income:	
Real Estate Rentals	₱ 42,634.78
25% of Dividends - ₱9,106.00	2,276.50
Interest Income	1,748.48
T o t a l	₱ 46,659.76
Less: Allowable deductions	16,800.30
Net taxable income	₱ 29,859.46
Tax due thereon	₱ 5,972.00
Add: ½% monthly interest from June 20, 1959 to November 8, 1960	495.67
TOTAL AMOUNT DUE	₱ 6,467.67

1 9 5 4

Taxable Income:	
Real Estate Income	₱ 30,040.61
25% of Dividends of ₱12,148.00	3,037.00
Total	₱ 33,077.61
Less: Allowable deductions	15,635.61
Net taxable income	₱ 17,442.00
Tax due thereon	₱ 3,488.00
Add: ½% monthly interest from June 20, 1959 to November 8, 1960	289.48
TOTAL AMOUNT DUE	₱ 3,777.48

1 9 5 5

Taxable Income:	
Real Estate Rentals.	₱ 34,147.42
Dividends - 25% of ₱17,171.40	4,292.85
Gain on Sale of SMB Shares	7,552.12
Gain on aliquot part of cafeteria bldg.	3,500.00
T o t a l	₱ 49,492.39
Less: Allowable Deductions	15,746.85
Net taxable income	₱ 33,745.54
Tax due thereon	₱ 6,749.00
Less: Amount already paid . .	1,479.00
B a l a n c e	₱ 5,270.00
Add: ½% monthly interest from June 20, 1959 to November 8, 1960	437.35
TOTAL AMOUNT DUE	₱ 5,707.35

Likewise, in addition to the aggregate amount of ₱16,852.41 demanded in the letter of respondent, dated November 8, 1960, the payment of the further sum of ₱640.00 as real estate dealer's fixed tax for the years 1952 to 1955, plus administrative penalties for late payment, was again demanded by respondent from petitioner;

8. That the deficiency income tax assessments for the years 1952 to 1955, inclusive, in the aggregate amount of ₱16,852.41 were arrived at by the respondent by adopting the following formula in computing the allocable deductions to non-taxable income:

$$\frac{\text{Taxable Income Less Dividends and Interest}}{\text{Taxable Income Less Dividends and Interest Plus Non-Taxable Income}} \times \text{Administration Expenses} = \text{Allo-ble deduct- to Non-Taxable In-come}$$

9. That in a letter dated December 7, 1960, filed with respondent on the same day, the petitioner protested the revised deficiency income tax assessments for the years 1952 to 1955 in the aggregate amount of ₱16,852.41 on the basis that petitioner's formula of allocating administrative expenses, to wit:

$$\frac{\text{All Taxable Income}}{\text{Gross Consolidated Income}} \times \text{Allocable Administrative Expenses}$$

is more reasonable and equitable;

10. That the issue to be resolved in this case is which of the two formulae for allocating administrative expenses - that of the petitioner or that of the respondent - is the correct formula;

11. That the parties hereby reserve their rights to introduce additional evidence not covered by

this Partial Stipulation of Facts in support of their respective contentions.

On December 2, 1967, petitioner rested its case after the presentation and admission of its sole evidence, i.e., Exhibit A (Articles of Incorporation of the Hospital de San Juan de Dios, Inc.).

This Court is called upon to resolve the following issues, to wit:

1. Which of the two formulae for allocating administrative expenses - that of petitioner or that of the respondent - is the correct formula; and

2. Whether or not petitioner is liable for real estate dealer's fixed tax and penalty for late payment thereof in the total sum of ₱640.00 for the years 1952 to 1955.

There is no dispute that petitioner is engaged in both taxable and non-taxable operations. The income derived from the operations of the hospital and the nursing school are exempt from income tax while the rest of petitioner's income are subject thereto. Its taxable or non-operating income consists of rentals, interests and dividends received from its properties and investments. In the computation of its taxable income for the years 1952 to 1955, petitioner allowed <u>all</u> its taxable income to share in the allocation of administrative expenses. Respondent disallowed, however, the interests and dividends from sharing in the allocation of administrative expenses on the ground that the expenses incurred in the administration or management of petitioner's investments are not allowable business expense inasmuch as they were not incurred in "carrying on any trade or business" within the contemplation of Section 30(a)(1) of the Revenue Code. Consequently, petitioner was assessed deficiency income taxes for the years in question.

The provision of the Revenue Code dealing on the deductibility of business expense insofar as it is relevant to the question at bar, provides 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, including a reasonable allowance for salaries or other compensation for personal services actually rendered; . . . (Underlining supplied.)

At the outset, we would like to emphasize that there are three conditions precedent which must be satisfied before a deduction will be allowed for a claimed business expense. The expense must be (1) incurred in carrying on a "trade or business," (2) "ordinary and necessary" and (3) "paid or incurred within the taxable year." (See 4 Merten's Law of Federal Income Taxation, par. 25.06, 1942 ed.)

Guided by the foregoing requirements, we hold that petitioner failed to establish by competent proof that its receipt of interests and dividends constituted the carrying on of a "trade or business" so as to warrant the deductibility of the expense incurred in their realization. No evidence whatsoever was presented by petitioner to show how it handled its investment, the manner it bought, sold and reinvested its securities, how it made decisions, and whether it consulted brokers, investment or statistical services. Neither is there any showing of the extent of its activities in stocks or bonds, and participation, if any, direct or indirect, in the management of the corporations where it made investments. In effect, there is total absence of any indication of a business-like management or operation of its interests and dividends. (See Roebling v. Comm. of Int. Rev., 37 BTA 82.) Instead, petitioner merely relied on the assumption that "if it is to handle its investment portfolio profitably, it has either to engage the services of an investment banker or administer it from within but the latter necessarily involves studying the securities market, the tax aspects of the investments, hiring accountants, collectors, clerical help, etc." without showing that it was actually performing these varied activities. Petitioner could have easily required any of its responsible officials to testify on this regard but it failed to do so. Under these circumstances and coupled with the fact that the interests and dividends here in question are merely incidental income to petitioner's main activity, which is the operation of its hospital and nursing schools, the conclusion becomes inevitable that petitioner's activities never go beyond that of a passive investor, which under existing jurisprudence do not come within the purview of carrying on any "trade or business."

> While the nature of the work is immaterial, such activity as may be involved in the mere receipt of income will not ordinarily constitute a trade or business. A passive recipient of income from property managed by other is not engaged in business, and this includes such incidental activities as may be necessary to the realization of income from one's personal estate. (4 Merten's Law of Federal Income Taxation, par. 25.06.)
>
> In Foss v. Commissioner, 75 F. 2d 326, "the line [between investors and persons engaged in business], comes between those who take the position of passive investors doing only what is necessary from an investment point of view, and those

> who associate themselves actively in the enterprises in which they are financially interested and devote a substantial part of their time to that work as a matter of business." (Kales v. Comm. of Int. Rev., 101 F. [2d] 35, 122 ALR 211.)
>
> The expense of renting an office and employing a staff to handle the taxpayer's extensive personal investments in stocks and bonds, involving the keeping of records, receiving securities and interest and dividend checks, making deposits, and forwarding reports to the owner, who exercised general supervision over his investments, is not deductible in ascertaining income subject to Federal income tax as an expense incurred in carrying on any trade or business. (Higgins v. Comm. of Int. Rev., 312 U.S. 212, 85 L. ed. 783.)
>
> In our opinion the mere receipt of income from the property leased (the property being used in business by the lessee, and not by the lessor) and the receipt of interest and dividends from invested funds, bank balances, and the like, and the distribution thereof among the stockholders of the Minehill Company, amount to no more than receiving the ordinary fruits that arise from the ownership of property. (McCoach v. Minehill, 57 L. ed. 842; underscoring supplied.)

Consequently, the formula adopted by respondent, wherein petitioner's income from interests and dividends were not allowed to participate in the allocation of administrative expenses, is correct.

Petitioner contends, however, that the assessments are without legal basis because of the principle that "if an item is indirectly attributed to both taxable income and exempt income, a reasonable proportion thereof, determined in the light of all the facts and circumstances in each case, shall be allocated to each." Petitioner further contends that the assessments run counter not only to the very purpose of the exemption which it enjoys but also against the very principles of reason and equity.

We have no quarrel with the principles cited by petitioner. We believe however that the principle of allocating expenses is grounded on the premise that the taxable income were derived from the carrying on of a trade or business as distinguished from the mere receipt of interests and dividends from one's investments. As we have clearly found in this case, the expenses incurred for handling the funds or income of petitioner consisting solely of dividends and interests were not incurred in "carrying on any trade or business"; hence, they are not allowable business expense. As a consequence, said income should not share in the allocation of administrative expenses.

Petitioner's appeal to reason and equity is beside the point. Suffice it to say that the allowance of deductions from gross income for income tax purposes does not turn on general equitable considerations, but depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed. (See Deputy v. Du Pont, 308 U.S. 488, 84 L. ed. 416.)

Coming now to the second issue, the records show that petitioner received rental income in the amounts of ₱26,176.33, ₱42,634.78, ₱30,040.61 and ₱34,147.42 for the respective years 1952, 1953, 1954 and 1955. Since its income from rentals exceeded ₱3,000.00 a year, petitioner is considered engaged in business as "real estate dealer" within the purview of Section 194(s) of the Revenue Code, and, therefore, subject to real estate dealer's fixed tax of ₱150.00 for each of the aforesaid years, or a total of ₱600.00, imposed by Section 193(q) of the same Code. (See Congregacion de la Mission de San Vicente de Paul v. Comm. of Int. Rev., CTA Case 1468, Oct. 14, 1968.) Moreover, we presume that petitioner has no objection to the assessment of real estate dealer's fixed tax because it did not object thereto either during the proceedings in the Bureau of Internal Revenue or before this Court.

With respect to the compromise penalty in the total amount of ₱40.00 for late payment of the real estate dealer's fixed tax, this Court is powerless to impose the same in the absence of any showing that petitioner consented thereto. (See Comm. of Int. Rev. v. Abad, L-19627, June 27, 1968; Algue, Inc. v. Comm. of Int. Rev., CTA Case 1620, Jan. 16, 1968.)

WHEREFORE, the decision appealed from, except as to the compromise penalty in the total sum of ₱40.00 which is hereby eliminated, is hereby affirmed. Petitioner is therefore ordered to pay the government the total sum of ₱16,852.41 as deficiency income taxes for 1952 to 1955, inclusive of the ½% monthly interest from June 20, 1959 to November 8, 1960, plus 5% surcharge for late payment and additional interest at the rate of 1% a month not exceeding three (3) years, and the sum of ₱600.00 as real estate dealer's fixed tax for 1952 to 1955. With costs against petitioner.

SO ORDERED.

Quezon City, August 29, 1969.

RAMON L. AVANCEÑA
Associate Judge

WE CONCUR:

ROMAN M. UMALI
Presiding Judge

ESTANISLAO R. ALVAREZ
Associate Judge