REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST LEPANTO-TAISHO INSURANCE CORPORATION,
Petitioner,

- versus -

C.T.A. CASE NO. 6160

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

MAY 3 1 2004

x -x

DECISION

This case involves the cancellation and withdrawal of the deficiency income tax and expanded withholding tax assessments issued by the respondent against the petitioner in the amount of **FIFTY SEVEN MILLION EIGHTY EIGHT THOUSAND ONE HUNDRED SIXTY AND 14/100 (P57,088,160.14) PESOS** covering the taxable year 1994.

Petitioner is a non-life insurance company, organized and existing under and by virtue of Philippine laws. As a non-life insurance company, it issues insurance policies for risks arising from fire, lightning, typhoon and flood, riot, strike and civil commotion, among others. It also insures against risks such as but not limited to, personal accident, robbery, and general liability. Various risks affecting motor vehicles and marine hull and cargo are also insured by petitioner. In addition thereto, petitioner also insures surety and fidelity bonds as part of its business (*par 1, Joint Stipulation of Facts).*

Respondent issued Letter of Authority No. 89951 dated August 24, 1995 which was superseded by Letter of Authority No. 132814 dated January 17, 1997. Under said letter, Revenue Officer Eulogio Madayag, with the supervision of Group Supervisor Myrna R. de Ocampo , was authorized to examine the books of accounts and other accounting records of petitioner covering the taxable year 1994 (*par 4, Joint Stipulation of Facts).*

Subsequently, a proposed deficiency income tax assessment was issued by respondent. Said assessment showed that petitioner had deficiency income tax in the amount of P51,675,518.71, inclusive of the 25% surcharge and interest. Accordingly, petitioner filed its protest thereon on May 6, 1997 through a letter dated May 5, 1997 (*par 5, Joint Stipulation of Facts).*

On July 14, 1997, respondent reiterated his stand on the proposed deficiency income tax assessment of petitioner and requested petitioner to settle the said amount, to which petitioner, in a letter dated July 23, 1997, restated its objections to the questioned proposed assessment.

Additionally, petitioner, subsequent to its July 23, 1997 letter, in a letter dated August 8, 1997 and filed on the same date, submitted to respondent, the schedules showing the particulars of the premium tax and reinsurance premiums ceded for the taxable year 1994.

On February 27, 1998 and January 8, 1999, respondent invited petitioner to verify the details of the proposed deficiency assessments. Upon receipt of the letters, petitioner met on various dates with respondent's examiners and discussed the proposed deficiency income tax assessments whereby petitioner reiterated its position as stated in its previous letters *(par. 9, Joint Stipulation of Facts).*

A Waiver of the Defense of Prescription was signed by petitioner on March 19, 1998 *(par. 10, Joint Stipulation of Facts)*.

On December 13, 1999, petitioner received the Assessment Notice No. 0000172-94-552 with Details of Discrepancies dated December 10, 1999 issued by respondent, assessing petitioner the amount of FIFTY SEVEN MILLION EIGHTY EIGHT THOUSAND ONE HUNDRED SIXTY AND 14/100 PESOS (P57,088,160.14) *(par. 11, Joint Stipulation of Facts)*.

On January 12, 2000, petitioner filed its letter-protest with the Office of the Revenue District Office No. 50, Revenue Region No. 8, challenging the correctness of the said assessment notice *(par. 12, Joint Stipulation of Facts)*.

Finally, on February 11, 2000, petitioner through a letter dated February 10, 2000, submitted a worksheet entitled "Summary of Reinsurance Transactions for the Year 1994" showing the amount of P148,282,137.00 allegedly representing gross premiums ceded (*par 14, Joint Stipulation of Facts*).

Before it could be barred by prescription, petitioner deemed it proper to file this petition before this court on September 8, 2000 for action.

On October 13, 2000, respondent filed his Answer and averred the following as his Special and Affirmative Defenses:

(6) The portion of the reinsurance premium ceded as claimed in petitioner's financial statement in the amount of P148,282,137.00 was disallowed pursuant to Section 34 (A)(1)(b) of the Tax Code because upon verification from the cash disbursement book of petitioner, it was found out that in 1994 only the amount of P35,694,739.52 was paid to the re-insurer while the accounts payable per books, as recognized and accounted for by its independent auditor, was only P37,356,355.00 so the total reinsurance premium paid and payable by petitioner per books and per audit is only P73,051,094.52, thus, resulting to the disallowance of the over-claimed reinsurance premium ceded in the amount of P75,231,150.70;

(7) The commission expense in the amount of P9,137,150.70 was also disallowed since the petitioner did not withhold, as admitted, the corresponding withholding tax due thereon pursuant to Section 9 of Revenue Regulations No. 13-78, as amended by Revenue Regulations No. 6-78 and 5-82, which provides that "any income payment which is otherwise deductible under Section 30 and 57 of the Tax Code, as amended, shall be allowed as deduction from the payor's gross income only if it is shown that the tax required to be withheld has been paid to the Bureau of Internal Revenue in accordance with Sections 53, 54, 91 and 93 also of the Tax Code";

(8) Mere allegation of the taxpayer that an item of expense is ordinary and necessary does not justify its deductions, he must not only meet the business test, he must substantially prove by evidence or records the deductions claimed under the law, otherwise, the same will be disallowed;

(9) The petition is premature because petitioner has not yet submitted the relevant documents in support of the "summary" it submitted, hence, the 180-day period under Section 228 of the National Internal Revenue Code of 1997 has not commenced to run since the period of inaction as contemplated in this section is counted from the submission of the documents;

(10) Instead, the assessment in question has already become final due to petitioner's failure to submit the relevant supporting documents within sixty (60) days from the filing of the alleged protest;

(11) It has been the consistent and uniform holding of the Supreme Court in a long line of cases that assessment issued by the Commissioner of Internal Revenue or his subordinate official is presumed correct and the taxpayer has the burden of showing that the assessment is illegal or improper;

(12) It is presumed that official duties have been regularly performed.

Petitioner and respondent stipulated the following as the issues to be resolved in this case, to wit:

1. Whether or not petitioner overclaimed its reinsurance premiums ceded to reinsurers by P75,231,042,48.

2. Whether or not petitioner is obliged to withhold expanded withholding tax on reinsurance commissions paid by petitioner to various reinsurance companies or original insurers.

3. Whether or not the reinsurance premiums ceded in favor of reinsurance companies in the amount of P75,231,042.48 and the commissions paid by petitioner in favor of reinsurance companies or original insurers are deductible.

4. Whether or not the petition was filed before the expiration of the 180-day period under Section 228 of the NIRC.

5. Whether or not the questioned assessments has already become final.

This court deems it proper to discuss the last two issues together first before resolving the other issues.

Respondent averred in his Answer that the present petition is premature because petitioner has not yet submitted the relevant documents in support of the "summary" it submitted. Hence, the 180-day period under Section 228 of the National Internal Revenue Code of 1997 has not commenced to run, instead, the assessment in question has already become final due to petitioner's failure to submit the relevant supporting documents within sixty (60) days from the filing of its alleged protest.

On the other hand, petitioner argued that it had submitted "all supporting documents" on February 11, 2000. Petitioner likewise asserted that respondent had 180 days from February 11, 2000 or until August 9, 2000 to resolve the protest as required under the provision of Section 228 of the NIRC.

We agree with petitioner.

Section 228 of the 1997 Tax Code provides:

> **"Section 228. Protesting an Assessment.** – x x x
>
> Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment in such form and manner as may be prescribed by implementing rules and regulations. **Within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final**. x x x" (Emphasis supplied)

From the foregoing, the petitioner has sixty days to submit **"all supporting documents"** in support of its protest, to the respondent. These supporting documents will enable the respondent to properly reconsider or reinvestigate the protested assessment, without which, respondent would not be in the position to provide for a reevaluated assessment.

Based on records, it is shown that petitioner, in a letter dated February 10, 2000 and received by the respondent on the same date, indeed submitted a 2-page worksheet entitled "Summary of Reinsurance Transactions for the Year 1994". Such document was the supporting document necessary to sustain its claim that it is not liable to pay the assessed deficiency income tax with surcharges and interest. In fact, on the same date, respondent issued a Tax Verification Notice No. TVN 1999-00010573 informing the petitioner that one of his revenue officers is already authorized to verify the supporting documents received pursuant to petitioner's request for reinvestigation. In other words, respondent affirmed receipt of the supporting document submitted by petitioner, as both have stipulated such submission *(par 13, Joint Stipulation of Facts).* Furthermore, nowhere in the records would show that respondent questioned the submitted relevant documents as insufficient or otherwise. Nor is there any showing that respondent requested for additional documents from the petitioner.

Now, to resolve the other issues.

Respondent claimed that the commission expenses paid by petitioner to the reinsurance companies are subject to withholding tax. Thus, petitioner's failure to withhold taxes from these commissions disqualifies petitioner from deducting the same from its gross income.

Petitioner, however, argued that the said commissions paid to reinsurance companies are not subject to the expanded withholding tax.

We concur with the petitioner.

Revenue Regulations No. 6-85 provides for the list of taxpayers who are subject to the expanded withholding tax. Section 1 of Revenue Regulations No. 6-85 is very clear. It provides that : "Except as otherwise herein provided, there shall be withheld a creditable income tax at the rates herein specified for each class of payee from the following items of income payments to persons residing in the Philippines". It then enumerates a list of those who are to be subject to withholding tax. And Section 1(a)(5) mentioned "Insurance agents and insurance adjusters". It does not provide for reinsurance companies or the like. This is especially true that under Section 25 (now Section 28), reinsurance premiums are exempt from income tax. Apparently, what the law excludes, we cannot include. As it is a settled rule in statutory construction that the express mention of one person, thing, or consequence implies the exclusion of all others. The rule is expressed in the familiar maxim, *expressio unius est exclusio alterius* [Agpalo, Statutory Construction, p. 160 (1986)].

With regard to the issue of deductibility, petitioner maintained that the reinsurance premiums it ceded in favor of the reinsurance companies and the commissions it paid out to these companies are deductible pursuant to Section 34(A)(1)(a) of the 1997 Tax Code.

We agree.

We quote hereunder the pertinent provision of the Tax Code for easy reference, to wit:

> **"Section 34. Deductions from Gross Income. – x x x**
>
> (A) Expenses.-
>
> (1) Ordinary and Necessary Trade, Business or Professional Expenses. –
>
> (a) In general – There shall be allowed as deduction from gross income all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on or which are **directly attributable to**, the development, **management, operation and/or conduct of the trade, business** or exercise of profession, including:

x x x x x x x x x"
(Emphasis supplied)

In the case of *Esso Standard Eastern, Inc. vs CIR (175 SCRA 149)*, the Honorable Supreme Court had laid down the test for deductibility of a business expense, to quote:

> We come, then, to the statutory test of deductibility where it is axiomatic that to be deductible as a business expense, three conditions are imposed, namely: (1) the expense must be ordinary and necessary, (2) it must be paid or incurred within the taxable year, and (3) it must be paid or incurred in carrying a trade or business. In addition, not only must the taxpayer meet the business test, he must substantially prove by evidence or records the deductions claimed under the law, otherwise, the same will be disallowed.

Based on the records and evidence submitted by herein petitioner, it can be said that petitioner had complied with the business test, as follows:

First, that the expense must be ordinary and necessary in carrying on or which are attributable directly to, the development, management, operation and/or conduct of the trade, business or exercise of a profession. When we say that an expense is ordinary, it simply refers to the expense which is normal, usual or common to the business, trade or profession. By necessary, it simply refers those expenses which are useful and appropriate in the conduct of the business, trade or profession.

As correctly pointed out by petitioner, Section 215 of the Insurance Code provides that, and we quote:

> **Section 215**. No insurance company other than life, whether foreign or domestic, shall retain any risk on any subject of insurance in an amount exceeding twenty per centum of its net worth. xxx

And because of such restriction, the contract of reinsurance became an ordinary or common conduct in the insurance world. In other words, reinsurance has become a normal and accepted practice. Through the contract of reinsurance, risks are spread over a greater number of insurers, instead of just one single original insurer. Furthermore, it lessens the risk of great losses a single insurer may incur in cases where a great number of catastrophes occur.

With regard to the second and third requirements, as can be shown from the evidence presented, petitioner had substantiated its claim that the ceded reinsurance premiums were paid and incurred during the taxable year 1994 and also that these were paid and incurred in carrying on business as an insurance company.

And finally, to the last issue.

Respondent disallowed a portion of the reinsurance premiums ceded by petitioner in the amount of P75,231,042.48 contending that this amount has been over claimed. Accordingly, upon verification from the cash disbursement books of the petitioner, only the amount of P35,694,739.52 was paid to the reinsurers, while the accounts payable per books showed only the amount of P37,356,355.00. As a result, the difference of P75,231,042.48 should be disallowed. Below is a detailed computation as shown on the assessment notice received by the petitioner:

Overclaimed Reinsurance Premium		P 148,282,137.00
Less:		
Paid to Reinsurer	P35,694,739.52	
Accounts Payable to Reinsurer per F/S	P37,356,355.00	P 73,051,094.52
OVERCLAIMED REINSURANCE PREMIUM CEDED		**P 75,231,042.48**
		==========

This court is not in agreement.

After a very thorough and careful scrutiny of the records and documents presented, it is evident that the amount of P75,231,042.48 disallowed by respondent as reinsurance premiums ceded during the taxable year 1994 was a result of an erroneous computation made by the respondent.

From the documents presented, it was found by this court that the total amount paid by the petitioner to its reinsurers, as properly reflected in its Cash Disbursement Books, totaled to P74,116,779.00 (*pp 60-245, 365-369, BIR Records)*, in contradiction to respondent's findings of P35,694,739.52. Also, the amount of P37,356,355.00 as detailed by respondent to be the total amount of *Accounts Payable to its Reinsurers per F/S,* represents the net reinsurance payable to affiliates as of December 31, 1994. In other words, the amount reflected as the total *Accounts Payable to its Reinsurers per F/S* constitutes only a portion of the total amount of accounts payable, which is in the reflected account of *Due to Reinsurers and Ceding Companies* as of December 31, 1994 in the amount of P77,910,698.00. This court believes that respondent should have taken into account the total amount reflected.

Furthermore, respondent failed to consider and deduct the net balance in the amount of P51,820,843.00 from the sum total of the cash payments and net balance of the account *Due to Reinsurers and Ceding Companies* as of December 31, 1994 in order to arrive at the actual expense for the year 1994.

In addition, as correctly pointed out by petitioner, the claimed reinsurance premiums ceded in the amount of P148,282,137.00 represented the gross amount and did not include the deductions for reinsurance commissions and other charges, such as treaty losses and reserve requirements, whereas, the payments to reinsurers which were reflected on the Cash Disbursement Book and the beginning and ending balances of the account *Due to Reinsurers and Ceding Companies* represented the net amount after deductions were made of reinsurance commissions and other deductions. To better illustrate, below is the computation:

Claimed Reinsurance Premium Ceded		P148,282,137.00
		==========
Accounted for as follows:		
Payments	P 74,116,779.00	
Adjustments	702,723.00	
Commissions & Other Deductions	47,372,780.00	
Accounts Payable To Reinsurers		
A/P ending	77,910,698.00	
A/P beginning	(51,820,843.00)	
Total		P148,282,137.00
		==========

Moreover, pursuant to the report submitted by the independent accounting firm commissioned by this court and through the testimony of one of its partners, the whole amount of P148,282,137.00 as the total amount of reinsurance premiums ceded by petitioner to the other reinsurance companies have been accounted for *(Exhibit "M6"; Testimony of Leticia Tagle, TSN dated February 12, 2002, CTA Docket)*. Excerpts from the said report as follows:

> "We were able to validate the amount of P 75,372,892.68 as reinsurance premiums ceded under facultative arrangements.
>
> The results of our examinations are summarized below.
>
> Amount of reinsurance premiums ceded claimed for deduction P 148,282,137.00
> Amounts accounted for:

Under treaty accounts	72,909,244.32
Under facultative arrangements	75,372,892.68

Total accounted for	P 148,282,137.00

Based on the results of our examinations, the amount of reinsurance premiums that the Company ceded for the year 1994 was P 148,282,137.00, which should therefore be allowed as a deduction amount from the company's taxable income for 1994.

Very truly yours,
ALBA ROMEO & CO

LETICIA C. TAGLE
Partner

Premises considered, it is concluded that petitioner has no overclaimed reinsurance premiums ceded for the taxable year 1994. The various Treaty Statements of Account (*Exhibits B, B-1 to B-39, C, C-1 to C-39, D, D-1 to D-13, E, E-1 to E-39, F, F-1 to F-35, G, G-1 to G-4*) and Reinsurance Request Notes (*Exhibits H, I to J-3, K to L-4-v, M to M-3, N to N-60, O-CCCC-1, DDDD to IIII-1, JJJJ to JJJJ-11, KKKK to OOOO-2, PPPP to LLLLL-17, MMMMM to MMMMM-8, NNNNN to SSSSS-32, TTTTT to LLLLLL-19*) are sufficient proofs that for the taxable year 1994, petitioner has actually ceded the reinsurance premiums of P148,282,137.00 to various reinsurance companies.

IN VIEW OF THE FOREGOING, this instant Petition for Review is hereby GRANTED. Accordingly, Assessment Notice No. 0000172-94-552 issued against petitioner for deficiency income tax for the year 1994 is hereby CANCELLED and SET ASIDE.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Justice

WE CONCUR:

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

CERTIFICATION

I hereby certify that the above decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Justice