REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

THE PHILIPPINE REALTY CORPORATION,
Petitioner,

- versus - C.T.A. CASE NO. 1271

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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Aug 20/74

D E C I S I O N

Upon verification of the amended income tax returns filed by petitioner Philippine Realty Corporation for taxable years 1951, 1952 and 1953, after previous assessments were sought to be reconsidered, respondent issued against petitioner a deficiency income tax assessment of ₱37,754.10 for 1951; reiterated his prior assessment of ₱6,200.00 for 1953; and credited against the 1953 deficiency income tax liability an alleged 1952 overpayment of only ₱12,500.00, instead of the sum of ₱25,820.00, as claimed by petitioner. This decision of respondent was received by petitioner on September 1, 1962 and the latter now asks this Court to review the same.

Petitioner is a real estate corporation organized and existing since August 2, 1930. Before World War II, it subdivided a large tract of land in Caloocan which is known as "Grace Park Subdivision".

Petitioner filed income tax returns for the years 1951, 1952 and 1953, subsequently amending such returns on August 2, 1955. In its amended income tax returns, petitioner claimed several items of deduction, but some of them were disallowed by respondent. Based on its amended income tax returns, petitioner reported that it incurred deficiency in its previous income tax payments, as follows:

Year	Tax due per amended return	Tax already paid (Original return)	Deficiency (Excess)
1951	₱ 184,037.00	₱ 133,783.00	₱ 50,254.00
1952	100,226.00	126,046.00	(25,820.00)
1953	109,259.00	111,773.00	(2,514.00)
		Net deficiency----	₱ 21,920.00

The taxpayer paid the aforesaid amount of ₱21,920.00 on March 15, 1956.

In his letters of April 16, 1952 and October 5, 1956, respondent assessed petitioner deficiency income tax in the amounts of ₱54,312.00 and ₱6,420.00 for the years 1951 and 1953, respectively. And in the same letter of October 5, 1956, respondent reduced the assessment for 1951 to ₱35,908.81, after allowing a tax credit of only ₱12,550.00 for 1952, instead of the amount of ₱25,820.00, as computed by petitioner as overpayment for that year. The taxpayer protested the foregoing assessments on March 27, 1957, but in his letter of August 29, 1957, respondent reiterated his assessments for 1951 and 1953, as well as the limited tax credit of only ₱12,550.00 for 1952.

On September 23, 1957, petitioner requested, and was granted, reinvestigation by respondent, but in his letter of October 21, 1958, the latter merely reiterated his assessment for 1951 and 1953 including the limited tax credit he had allowed for 1952. The taxpayer submitted a memorandum on the disputed assessments on January 12, 1959. In his letter dated August 10, 1962, respondent reduced his assessment for 1951 but reiterated his assessment for 1953, including the limited tax credit for 1952. Hence, this appeal.

The controversy between the parties centers on the legality of the deduction of certain items claimed by petitioner in its amended income tax returns for the years 1951, 1952 and 1953 which were disallowed by respondent.

After carefully examining all the items disputed by the parties and the arguments stated by them in support of their respective positions, we are convinced that, despite the seemingly conflicting views taken by them, there is no real dispute between petitioner and respondent on the fundamental principles governing the deductibility or non-deductibility of the items involved. The parties are in agreement on the provisions of law, regulations, legal principles and computation of taxes paid by petitioner. Petitioner's claimed deductions are all supported by adequate records, establishing not only the fact of payment but also the correctness of the amount paid, as well as the taxable years when deductions were claimed. A lot of ground can at once be covered, and it will greatly help simplify matters if the various items disputed by the parties are presented in outline form, as follows:

1951

Net income per amended return		₱685,846.72
Add (Disputed items):		
1. Deduction for construction of Our Lady of Grace Church (Total ₱20,000.00; claimed as deduction	₱12,701.27	
2. Repairs of old and construction of new toilet of our Lady of Grace Academy	373.00	13,074.27
Net income per investigation		₱698,920.99
Tax due thereon (20% - 28%)		₱187,699.00
Less: Amount previously paid		133,783.00
Deficiency (basic)		₱ 53,916.00

1952

Net income per amended return		₱386,522.41
Add (Disputed items):		
1. Reception-Cardinal Spellman	₱ 500.00	
2. Masses-Arch. M. O'Doherty	3,000.00	
3. Audit fees-A. Deato	700.00	
4. Road construction and repairs	43,192.44	47,392.44
Net income per investigation		₱433,914.85
Tax due thereon		₱113,496.00
Less: Amount previously paid		126,046.00
Overpayment		₱ 12,550.00

1953

Net income per amended return		₱418,779.75
Add (Disputed items):		
1. Thanksgiving Mass	₱ 200.00	
2. Wreath-Don Gabriel LaO	25.00	
3. Gregorian Masses - Don Gabriel LaO	200.00	
4. Road construction & repairs	76,307.96	76,732.96
Net income per investigation		₱495,512.71

Tax due thereon	₱130,743.00
Less: Amount previously paid	111,773.00
	₱ 18,970.00
Tax credit for 1952	12,550.00
Deficiency (basic)	₱ 6,420.00

We will now resolve these disputed items *ad seriatim* and in their chronological order.

1. Construction of Our Lady of Grace Church - ₱12,701.27 - Respondent's disallowance of this item of ₱12,701.27 is based on his examiner's belief that petitioner was claiming it as a business expense and should, therefore, be capitalized because it involved "construction". In its original return and amended return, however, petitioner claimed that it made a charitable contribution to the Oblate Fathers of the amount of ₱20,000.00 for the construction of the Our Lady of Grace Church, but in view of the limitations of Section 30(h) of the National Internal Revenue Code on charitable contributions, it deducted only the sum of ₱12,701.27 out of the total contribution of ₱20,000.00. Respondent's examiner admitted on cross-examination during the hearing of this case before this Court that this item had been claimed in the original and amended returns as a charitable contribution. (T. s. n., p. 443.)

The records show that the Oblate Fathers is a religious corporation known as "Oblate of Mary Immaculate Inc.". While it was incorporated only on

April 13, 1971, this religious congregation came to the Philippines way back in 1939 and was in charge of the Our Lady of Grace Church up to 1971. At the time the contribution was made in 1951, the Oblate Fathers may, therefore, be considered as a religious organization within the meaning of the law. (Roxas v. Court of Tax Appeals, G. R. No. L-25013, April 26, 1968; 23 SCRA 276.) Since the sum of ₱12,701.27 is within the allowable amount of 3% of the net income before charitable contribution, the same is deductible from gross income of petitioner for 1951.

2. <u>Repairs of old toilet - Our Lady of Grace Academy - ₱373.00</u>. - The evidence shows that this small school was owned by petitioner and was set up because of the clamor of the residents in petitioner's Grace Park Subdivision. This Court can take notice of the fact that, as part of promoting or enhancing their trade or business, subdivision owners are sometimes compelled to make major improvements in their subdivisions, such as good roads, public markets, chapels, water system, school buildings. Since the construction of the Our Lady of Grace Academy was in connection with petitioner's business as a real estate dealer, the cost of the repairs of its old toilets which neither materially add to the value of the property nor appreciably prolong its life but merely kept it in an ordinarily efficient operating condition should be deducted

as business expense for 1951. (Sec. 68, Rev. Reg. No. 2; Gancayco v. Coll. of Int. Rev., G. R. No. L-13325, April 20, 1961; 1 SCRA 980). Expenditures for the maintenance of property are in the nature of good housekeeping habits. They are generally recurrent items that keep the property in an operating condition over its probable useful life but do not appreciably prolong its life. (1965 PH Fed. Taxes, Par. 11,477). The amount of ₱373.00 representing repairs of the old toilet of the Our Lady of Grace Academy is, therefore, deductible as business expense for 1951.

3. Reception - Cardinal Spellman - ₱500.00

Coming now to the 1952 amended income tax return of petitioner, one of the items claimed as ordinary and necessary deductible expense is the amount of ₱500.00 which was given as a contribution for the reception of Cardinal Spellman. The amount was received by a certain Santiago Freixas who was then one of the members of the reception committee. The evidence shows that petitioner had filed a substantial claim for war damage and the president of the corporation approached the Cardinal for his help in the processing of its claim in the United States. (T.s.n. pp. 73-74).

Contributions which may be considered as ordinary and necessary business expense and allowed as deduction are those which legitimately represent a consideration for a benefit flowing directly to the corporation as incident to its business. For example, contributions to fiestas may be deductible if such celebrations would enhance the business of the contributor. (1955 PH Fed. Taxes, Par. 12,707). Since the purpose of the expenditure was primarily business rather than social or personal and the business in which petitioner is engaged was intended to be benefited by such contribution (1965 PH Fed. Taxes, P. 11,163), the amount of ₱500.00 may be considered as ordinary and necessary business expense and allowed as deduction for 1952.

4. Masses for Msgr. Michael O'Dougherty - ₱3000.00. - Another item disallowed by respondent as a deduction in the 1952 income tax return of petitioner is the sum of ₱3,000.00 which was spent for low masses for the repose of the soul of the late Archbishop Michael O'Dougherty. It appears that the principal stockholder of the taxpayer is the Archdiocese of Manila, and as Msgr. O'Dougherty was the then incumbent Archbishop of Manila, petitioner claims that he was in effect its principal stockholder. (T.s.n. pp. 76-78). Instead of spending thousands of pesos on announcements and obituaries, petitioner, taking into account the relationship with the deceased and the episcopal dignity of such decedent, found it fitting and proper to spend ₱3,000.00 in low masses for the

repose of his soul (t.s.n. p. 80), as "such payments are the accepted method of expressing appreciation for valuable services rendered in the past and assisting in a tangible manner the relatives of the deceased" (p. 8, Memorandum of petitioner, p. 111, CTA records). Deduction of said amount may, therefore, be allowed if it is shown to be a compensation paid to Msgr. O'Dougherty or his heirs for past services rendered.

The test of deductibility in the case of compensation payments is whether they are reasonable and are, in fact, payments purely for service. (Sec. 70, Rev. Reg. No. 2.) And while the amount of the salary of an officer or employee which is paid for a limited period after his death to his widow or heirs, in recognition of the services rendered by the individual, may be deducted (Sec. 73, Rev. Reg. No. 2), the evidence presented does not show of any officer or employee relationship between petitioner and Msgr. O'Dougherty. That he was then the head of the Archdiocese of Manila and the Archdiocese of Manila is the principal stockholder of the taxpayer did not, standing alone, make him an officer or employee of petitioner. Payments to his relatives in the form of masses which did not have in them the element of compensation for services rendered cannot, therefore, be deducted. And even on the premise that Msgr. O'Dougherty was in effect the principal stockholder of the taxpayer, in accordance with petitioner's argument, such payment would partake of the nature of an indirect dividend which could not also be deducted by petitioner.

5. Audit Fees - Avelino Deato - ₱700.00

With respect to the amount of ₱700.00 paid by petitioner to Avelino Deato as audit fees, it appears that the same was disallowed by respondent because the examiner thought that it was in payment of audit work performed in 1948 and, therefore, should have been deducted in that year. While the audit work covered years prior to 1952, Avelino Deato was hired to do such work in the early 1952 and he actually completed his work around the time he was paid on May 6, 1952. (t.s.n. pp. 353-354.) As a matter of fact, the examiner testified during the hearing of this case before this Court that if he had known of these facts, he would have allowed the expense. (t.s.n. p. 576.) Since this represents payment for services actually rendered and the reasonableness of the amount has not been questioned (Sec. 70, Rev. Reg. No. 2), there seems to be no doubt as to the deductibility of the audit fees of ₱700.00.

6. Thanksgiving Mass - ₱200.00. - The evidence shows that this item of ₱200.00 was for a Thanksgiving Mass on the occasion of the annual stockholders' meeting and petitioner incurred no other expense in

connection with that special event. (T.s.n. p. 88.) While, as a general rule, entertainment expenses to be deductible as business expenses must be made to drum up business or with the reasonable expectation of obtaining a business benefit (1965 PH Fed. Taxes, P. 11,163), considering that the Archdiocese of Manila is the principal stockholder of petitioner, this item of ₱200.00 for a Thanksgiving Mass may be considered as deductible expense directly related to business meetings of stockholders. (1965 PH Fed. Taxes, P. 11,161.) Petitioner incurred no other expense on that occasion and had this amount been spent for food and drinks, instead of for a Thanksgiving Mass, there would be no doubt as to its deductibility as expense directly related to business meetings of stockholders. This Court can take judicial notice of the practice of some business enterprises owned or controlled by religious organizations of observing their annual meetings with a religious touch for thanksgiving and continued success instead of a business meal for the stockholders or the officers.

7. & 8. Gregorian Masses (₱200.00) and Wreath (₱25.00) for Don Gabriel LaO. - These two items of ₱200.00 and ₱25.00 were expenses incurred on the occasion of the death of Don Gabriel LaO who, at the time of his death, was president of petitioner corporation. (T.s.n. pp. 92-94.) An employer's expenses in connection with social and other activities incurred to improve

employer-employee relations, to build up good will and to increase efficiency are generally deductible. (1965 PH Fed. Taxes, P. 11,182.) In our country, where there is a deep and abiding respect for the dead, such payments are the accepted method of remembering and expressing appreciation, on the part of the employer, for valuable services rendered by officers and employees. Knowing that even after death they will be remembered by their employer, such token of remembrance builds up good will, develops loyalty and improves employer-employee relations, specially on the part of the key officers. There being a link between the expenses incurred and the business of petitioner, the amounts of ₱200.00 and ₱25.00 spent for Gregorian Masses and wreath for Don Gabriel LaO are deductible.

9. Road Construction and Repair - ₱43,192.44 (1952)and ₱76,307.96 (1953).- The records show that long before World War II, petitioner, a pre-war corporation, developed and subdivided the now known "Grace Park Subdivision" in Caloocan City (then a municipality). The roads were properly laid out and constructed, including the necessary improvements, consisting of curbs, gutters, canals and drainage system. The cost of all these permanent improvements were capitalized and added to the cost of the raw land. (T.s.n. pp. 132-136.)

Then came World War II. It appears that squatters occupied the subdivision, even constructing shanties on street lots. Drainage pipes were stolen and, in certain sections, destroyed. (t.s.n. p. 151)

Because of the dilapidated condition of the roads and the drainage system, complaints poured in not only from the residents of the subdivision but also from the Municipality of Caloocan. To relieve itself as owner of the duty of maintaining the streets of the subdivision, petitioner offered to donate the street lots to the then Municipality of Caloocan but the latter was unwilling to accept the donation unless the roads were first placed in good condition. (t.s.n. pp. 153-158.) After the street lots were restored to proper condition, the Municipality of Caloocan accepted the donation. It appears, however, that at the time the outlay for restoring the streets lots were incurred, practically all the lots in the subdivision had been sold. Petitioner did not lay out new streets as all the roads had been laid out and constructed before the war.

There is no dispute between the parties that the amounts of ₱43,192.44 and ₱78,307.96 were spent by petitioner in 1952 and 1953, respectively, for the purpose of restoring the roads in the subdivision to their proper condition as described above. For purposes of income tax deduction, however, respondent contends that these amounts should have been capitalized. Petitioner avers, on the other hand, that since it did not open a new phase in its subdivision nor lay out new streets but merely restored the old roads to their pre-war condition, these outlays should be deducted as expenses.

The cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life but keep it in an ordinarily efficient operating condition may be deducted as expense provided the plant or property account is not increased by the amount of such expenditure. Repairs in the nature of replacement to the extent that they arrest deterioration and appreciably prolong the life of the property should be charged against the depreciation reserve if such account is kept. (Secs. 68 and 120, Rev. Reg. No. 2; Gancayco v. Coll. of Int. Rev., G. R. No. L-13325, April 20, 1961[1 SCRA 980]; Brinker v. Coll. of Int. Rev., C.T.A. Case No. 366, July 17, 1959.) Stated otherwise, expenditures for the restoration of damaged property are generally deductible as business expenses if the effect is to merely restore the property to its normal operating condition. However, if the restoration results in the substitution of something different and better, the expenditure is deemed to be a replacement and usually must be capitalized. (1965 PH Fed. Taxes, P. 11,479.)

Since what petitioner did was merely to restore the existing streets in the subdivision to their pre-war condition by repairing the damaged sections that were potholed and constructing practically new ones in street sections that had been completely destroyed or washed away, the outlays of P43,192.44 for 1952 and P76,307.96 for 1953 under item road construction and repair are, therefore, deductible as business expenses.

To summarize, no deficiency income tax is due for 1951 from petitioner. For 1952, it is liable to pay deficiency income tax in the sum of P991.20, computed as follows:

1952

Net income per amended return	P386,522.41
Add: Unallowable deduction:	
Masses-Arch. M. O'Dougherty	3,000.00
Net income per review	P389,522.41
Tax due thereon	P101,066.00
Less: Amount previously paid	100,226.00
Deficiency income tax due	P 840.00
Add: 1/2% monthly interest from 6-20-59 to 6-20-62	151.20
Amount still due	P 991.20

No deficiency income tax is also due for 1953 from petitioner.

WHEREFORE, the decision appealed from is modified. Petitioner Philippine Realty Corporation is hereby ordered to pay the amount of P991.20 as deficiency income tax for 1952. If the amount of P991.20 is not paid within thirty (30) days from the time this decision becomes final and executory, petitioner shall be liable for the penalties provided in Section 51(e) of the Revenue Code. No costs.

SO ORDERED.

Quezon City, August 20, 1974.

ROMAN M. UMALI
Presiding Judge

WE CONCUR:

ESTANISLAO R. ALVAREZ
Associate Judge

RAMON L. AVANCEÑA
Associate Judge