REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

CONSOLIDATED MINES, INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 565

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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

CONSOLIDATED MINES, INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 578

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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

D E C I S I O N

Upon agreement of the parties, the above entitled cases were jointly heard and submitted for decision by the parties involving as they do identical parties and allied issues. Hence, this joint decision.

C.T.A. Case No. 565 is an appeal from the decision of respondent Commissioner of Internal Revenue, dated June 24, 1958 (Exh. A, pp. 205-207, BIR rec., C.T.A. No. 565; also marked as Exh. 32) assessing and demanding from petitioner Consolidated Mines, Inc., deficiency income taxes for the years 1951, 1952, 1953 and 1954, in the amounts of ₱15,576.00, ₱5,597.00, ₱186,972.00 and ₱211,802.00, respectively, or a total amount of ₱419,946.50.

C.T.A. CASE No. 578 is a petition for the review of the decision on the disputed deficiency income tax assessment, dated July 30, 1958 (Exh. A-5, p. 26, BIR rec.; C.T.A. No. 578; also marked as Exh. 35) for the year 1956 only in the sum of ₱72,082.00.

It appears that the petitioner herein is a domestic corporation engaged in the mining business. For the years in question (1951-1954, & 1956), it timely filed its income tax returns and paid the total amount of ₱7,590.709.00 as income tax on the basis of the net incomes reported in said returns. Petitioner's income tax returns were referred to an examiner of the Bureau of Internal Revenue for verification and investigation as a result of which certain deductions were disallowed and/or alleged unreported income was added. Consequently, the respondent issued against the petitioner the disputed deficiency income tax assessments under review.

It should be noted that in C.T.A. Case No. 565 which covers the years 1951 to 1954, the respondent imposed a 50% surcharge as fraud penalty but no such surcharge was assessed in C.T.A. Case No. 578 for the year 1956.

In the same order in which they are considered in the deficiency income tax assessments under review, the items which are the subjects of the present controversy are the following:

(1) Participation of Benguet Consolidated Mining Company on the net Accounts Receivable at the end of each year;

(2) Mine Depletion overcharged;

(3) Depreciation adjustments;

(4) Disallowed audit and legal fees for the year 1953 only; and

(5) Disallowed miscellaneous expenses for the years 1953, 1954, and 1956.

For an orderly discussion and determination of the issues in these two cases, we shall consider the above items separately.

PARTICIPATION OF BENGUET CONSOLIDATED MINING COMPANY ON THE NET ACCOUNTS RECEIVABLE -

There is no dispute that the petitioner has been filing its income tax returns on the basis of accrued income and expenses, but has consistently not provided as a deduction from its gross income for any particular year, any share of its operator, Benguet Consolidated Mining Co., in its accounts receivable at the end of each taxable year. (Memorandum for Petitioner, pp. 84-85, CTA rec. No. 565; Memorandum for Respondent, p. 119, CTA rec. No. 565.)

There is also no question that the position of the respondent with regard to this item is stated in his examiner's memorandum of January 26, 1957, as follows:

> "Consolidated Mines, Inc. (otherwise referred to as OWNER) consistently failed to provide, as a deduction from its income, the share of Benguet Consolidated Mining Company (otherwise referred to as OPERATOR) on its accounts receivable at the close of

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> the calendar year. The mine fields of the Owner corporation are subject to a contract of operation in which the contract provides that the Operator will share 50% of the net proceeds after deducting all expenses. Consolidated Mines, Inc., files its income, for tax purposes, on accrual basis, but leaves out the provision for the share of the Operator on the receivables. The expenses pertaining thereto are taken up as deduction from the operation of the next succeeding year when the receivables are actually collected and the share of the Operator is actually paid out." (Exh. 8, p. 123, BIR rec., CTA No. 565.)

The petitioner claims that the procedure it has followed with regard to the participation of Benguet Consolidated Mining Co., is "the only logical and practical method which it can apply by virtue of the particular and peculiar provisions of its operating contract with the operator of its mining properties", citing paragraphs X and XIV of the operating agreement, dated July 9, 1934 (Exh. L), which provide as follows:

> "X. After BENGUET has been fully reimbursed for its expenditures, advances and disbursements as aforesaid the net profits from the operation shall be divided between BENGUET and CONSOLIDATED share and share alike, it being understood however, that the net profits as the term is used in this agreement shall be computed by deducting from gross income all operating expenses and all disbursements of any nature whatsoever as may be made in order to carry out the terms of this agreement."

> "XIV. All payments due CONSOLIDATED by BENGUET under the terms of this agreement with respect to expenditures made and ore settlements received during the preceding calendar month, shall be payable on or before the twentieth day of each month."

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To our mind, a mere reading of the above quoted provisions of the agreement will readily show that there is nothing therein which could have prevented the petitioner from deducting at the end of each calendar year the share of Benguet Consolidated Mining Co. on the accounts receivable. And on this point, we quote with approval the following opinion of petitioner's auditors, Ollada, Dacanay & Associates, as contained in its letter dated April 22, 1954, to the respondent Commissioner of Internal Revenue:

> "The operating contract between the Consolidated Mines, Inc., and Benguet Consolidated Mining Co., provides that they SHARE ON 50-50 BASIS IN THE EXCESS OF RECEIPTS OVER DISBURSEMENTS (Par. X of the Agreement). It is submitted that the operator, Benguet Consolidated Mining Co., has to share with the accounts receivable minus the trade and accrued expenses and those due to hauling contractors which should be considered to determine the net receivable subject to the share-and-share-alike-basis when actually collected. In our opinion, the Consolidated Mines, Inc., should not pay the corresponding income tax on the uncollected accounts during the period for which the operator (Benguet Consolidated Mining Co.) would share alike in the excess of receipts over disbursements when actually collected. The accounting system of the Consolidated Mines, Inc., is also based on the ACCRUAL BASIS and it is therefore but consistent and logical that the share of the operator as shown above shall be excluded from the computation of the net tax liability of our client." (Exh. G, pp. 23-25, BIR rec., CTA No. 565; also marked as Exh. 6.)

It is true that the said letter of Ollada, Dacanay & Associates, Certified Public Accountants, was not authorized, and later disowned, by the petitioner. However, considering that the opinion expressed therein is correct, we take it and adopt the same as our own for purposes of disposing of the instant question of deduction from petitioner's income tax returns of the participation of Benguet Consolidated Mining Company on the net accounts receivable. Therefore, we believe and so hold that the ruling of respondent Commissioner of Internal Revenue with regard to the participation of Benguet Consolidated Mining Co., on the net accounts receivable is in accordance with law and must be affirmed.

MINE DEPLETION OVERCHARGED -

The petitioner has consistently charged off from its gross income mine depletion at the rate of ₱1.00 per ton of chrome ore mined and sold. However, the respondent contends that considering the correct amount to be depleted and the estimated ore deposit of petitioner's mine, the unit depletion charge should only be ₱.59189, and the petitioner is therefore overcharging mine depletion. Hence, the respondent insists that the petitioner is under-stating its income and the deficiency assessments with regard to this item is in order.

We find the contention of the respondent to be meritorious. In computing the net income, depletion of mines is allowed as a deduction from the gross income by Section 30 (g) (1) of the Tax Code which provides in part as follows:

> "(g) Depletion of oil and gas wells and mines:
>
> "(1) In general.- x x x (B) in the case of mines, a reasonable allowance for de-

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> pletion thereof not to exceed the market value in the mine of the product thereof, which has been mined and sold during the year for which the return and computation are made. The allowances shall be made under rules and regulations to be prescribed by the Secretary of Finance: Provided, That when the allowances shall equal the capital invested, x x x no further allowance shall be made."

And in general, the depletion formula that should be followed in computing the unit depletion charge or the rate of depletion per unit, i.e., ton, feet, etc., is as follows:

$$\frac{\text{COST OF MINE PROPERTY}}{\text{ESTIMATED ORE DEPOSIT}} = \text{RATE OF DEPLETION PER UNIT OF PRODUCT MINED AND SOLD}$$

In the case at bar, the dispute centers on the correct amount to be depleted and the estimated number of tons of ore deposits in petitioner's mine. As to the amount to be depleted, the petitioner used ₱4,238,974.57 as the cost of its mine property, including the development expenditures, based on its balance sheet as fo December 31, 1946. (Exhs. I & I-1) However, we find this figure not reliable and conclusive. It cannot be taken as an accurate statement of the depletable amount inasmuch as it is based merely on an estimate of Mr. R. P. Flood, then treasurer of the petitioner corporation. (Exh. 38, pp. 50-52, CTA rec. No. 565.)

Moreover, it appears from petitioner's balance sheet as of December 31, 1957 (Exhs. 1, 1-A, & 1-B, p. 48, CTA rec. No. 565), that this amount of ₱4,238,974.57

consists of the following items, namely: "Development Cost - ₱2,500,000.00" and under the suspense account "Mining Properties (Subject to adjustment for war losses) - ₱1,738,974.57". If the mining properties in the amount of ₱1,738,974.57 were subject to adjustment for war losses, as in fact the petitioner actually incurred losses during the war, there can be no justifiable reason to warrant its restoration, in full, to the total amount to be depleted. To do so, would allow the petitioner to recover the cost of the assets destroyed during the war by over-charging depletion. But it is now a settled rule in this jurisdiction that war losses are deductible only in the year in which they are incurred (Cu Unjieng Sons, Inc. vs. Board of Tax Appeals, G.R. No. L-6296, Sept. 29, 1956; Hilado vs. Collector of Internal Revenue, G.R. No. L-9408, Oct. 31, 1956; 53 OG 2481), and cannot, and should not, be the subject of depletion.

On the other hand, the depletable amount of ₱2,646,878.44 which was used by the respondent in computing the rate of depletion, was a result of the investigation and verification of the records of the petitioner which was conducted by an internal revenue agent. (Exh. 31, pp. 197-201, BIR rec., CTA No. 565) And the respondent in arriving at the total amount of ₱2,656,878.44 which should be subjected to depletion considered the following items which were taken from the books of the petitioner:

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Assessment	₱ 34,092.12
Development	61,484.63
Exploration	13,966.62
Diamond Drilling	22,335.07
	₱2,646,878.44

(See Exh. 31, pp. 197-201, BIR rec., CTA No. 565.)

It should be noted that the petitioner never directly questioned the above figures adopted by the respondent. At most, the petitioner made a general assertion that the "figure of ₱2,646,878.44 which the examiner would use as the Masinloc Mine Property Cost and Development is patently inadequate". (Exh. 29, pp. 188-195, BIR rec., CTA No. 565) Considering further that the finding of the respondent Commissioner of Internal Revenue is presumptively correct, we hold that the depletable amount is only ₱2,646,878.44, and not ₱4,238,974.57 as claimed by the petitioner.

With regard to the estimated ore deposits, the petitioner claims that the same should be placed at 4,156,888 while the respondent contends that it should be 4,471,892 tons, or a difference of 315,004 tons.

To resolve this question, it shall suffice to state that the petitioner has admitted that "by the year 1956, it had already charged off its entire depletion mine cost and development of ₱4,238,973.57 (except the sum of ₱82,464.63 which was charged off in the year 1957) at the rate of ₱1.00 per ton of ore" (Memorandum for Petitioner, p. 82, CTA rec., No. 565). In the year 1958, the petitioner was already carrying in its books, the mine and mine development cost at the nominal cost of ₱1.00, and at the same time, it reported to its stockholders that "with world trade and production on the up-swing, your company (the petitioner) has every reason to look forward to increased gains during the incoming year" (1959). (Annual Report of Consolidated Mines, Inc., for the year 1958, marked as Exh. Q-11; underscoring supplied.)

In short, in 1957, the petitioner had already mined and sold more than 4,321,438 tons, or more than its estimate of its ore deposit. To our mind, this conclusively shows that the figure of 4,471,892 tons used by the respondent was not only reasonable but very conservative and liberal in favor of the petitioner. Therefore, the rate of depletion or the unit depletion charge used by the respondent is correct and his finding of over-charging depletion must be sustained.

DEPRECIATION -

With regard to the depreciation disallowed by the respondent Commissioner of Internal Revenue, it shall suffice to state that the taxpayer herein failed to present sufficient evidence to justify its claim for said deduction. Inasmuch as the allowance of the deductions from the gross income is a matter of legislative grace (Mertens, Law of Federal Income Taxation, 1942 Edition, Vol. 4, pp. 4-5), and the burden of proof is on the taxpayer to sustain the depreciation deduction, (Sec. 109, Rev. Reg. No. 2), we hold that the disallowance by the respondent Commissioner of Internal Revenue of the depreciation deduction claimed by the petitioner is in accordance with law.

AUDIT AND LEGAL FEES -

In this jurisdiction, it is already settled that professional fees paid to accountants and lawyers are deductible from the gross income in computing the net income. (Collector of Internal Revenue vs. Phil. Education Co., G.R. No. L-8505, May 30, 1956; 54 OG 2499.)

In the instant case, the audit and legal fees disallowed by the Commissioner of Internal Revenue is in the amount of ₱30,000.00 for the year 1953. There is no question that the said audit and legal expenses were actually incurred by the petitioner (see Exhs. M-1 to M-7) whose gross income for the same year under review was ₱14,141,853.67. (Exh. D-1, p. 12, BIR rec.; CTA No. 565) And we find and so hold that the respondent Commissioner of Internal Revenue should have allowed the said expenses as deductions from petitioner's gross income inasmuch as they are necessary and reasonable expenses paid or incurred in carrying on the business of the petitioner.

MISCELLANEOUS EXPENSES -

The amounts of the miscellaneous expenses which were disallowed by the respondent Commissioner of Internal Revenue are as follows:

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1953 - - - - - - - - ₱30,000.00

1954 - - - - - - - - ₱39,081.20

1956 - - - - - - - - ₱20,050.00

We have carefully examined the evidence presented by the taxpayer herein with regard to these disputed miscellaneous expenses, and we find and so hold that the following expenses paid or incurred by the petitioner should have been allowed by the respondent as deductions from the gross income:

For the year 1953:

The whole amount of ₱30,000.00 (see Exhs. M-1 to M-4)

For the year 1954:

The sum of ₱25,600.00 only, paid to or itemized as follows:

V. E. del Rosario -------	₱10,000.00	(Exhs. N-1 to N-3)
Salvador Santiago -------	₱ 9,000.00	(Exhs. N-4 & N-5)
Custodio Villaba --------	₱ 6,500.00	(Exh. N-6)
Malacañang Christmas Festival --------------	₱ 100.00	
Total -------	₱25,600.00	

The balance of ₱13,481.20 of the disallowed expenses for the year 1954 cannot be granted as deductions for lack of any supporting paper or evidence. (See Exh. N, also marked as Exh. 8-A, p. 85, BIR rec.; CTA No. 565.)

For the year 1956:

The amount of ₱2,460.00 which represents the one-month salary christmas bonus paid to some of the employees

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of the petitioner should be allowed as a deduction from the gross income. (See Exhs. O-1 & O-2) With regard to the balance of ₱17,590.00 of the disputed miscellaneous expenses, we affirm the action of the respondent Commissioner of Internal Revenue inasmuch as the petitioner herein failed to prove substantially that the said expenses were actually incurred and are legally deductible expenses. (See Exh. O, p. 2, BIR rec.; CTA No. 578.)

We note that, except for the sum of ₱100.00 which the petitioner contributed in 1954 to the Malacañang Christmas Festival and therefore deductible as a charitable contribution under Section 30(h) of the Tax Code, and the amount of ₱2,460.00 which was paid in 1956 as a salary christmas bonus and hence also deductible under Section 30(a) of the Tax Code, all the other allowable expenses are in the nature of audit and legal fees or expenses. As stated above, in this jurisdiction, it is an established principle in taxation that professional fees paid to accountants and lawyers are deductible from the gross income. (Collector of Internal Revenue vs. Phil. Education Co., <u>supra</u>.) We therefore hold and so declare that all the disputed miscellaneous expenses mentioned above which are in reality audit and legal fees or expenses should be deducted from the gross income in computing the net income for the years under review pursuant to Section 30(a) of the Tax Code.

THE 50% FRAUD PENALTY -

The petitioner also disputes the imposition of the fifty per cent (50%) surcharge which was assessed by the respondent pursuant to the provisions of Section 72 of the Tax Code. The petitioner contends that the imposition of the surcharge or fraud penalty is unwarranted and without basis.

We agree with the contention of the petitioner. The question of fraud is a question of fact. The records of the instant case show that the facts and circumstances surrounding the filing of income tax returns under review do not justify the assessment and collection of the 50% surcharge. (Gutierrez vs. Court of Tax Appeals, G.R. No. L-9738, May 31, 1957; 54 OG 2912.) As a matter of fact, the respondent Commissioner of Internal Revenue assessed the 50% penalty only in C.T.A. Case No. 565 which covers the years 1951 to 1954, and did not impose the same penalty in C.T.A. Case No. 578 which involves the income tax liability of the petitioner for the year 1956 only. But we note that the income tax returns in both C.T.A. Cases Nos. 565 and 578 were filed under practically the same circumstances. We believe this supports the conclusion that the respondent was, at least, not sure as to whether or not the petitioner willfully made and filed false or fraudulent income tax returns. And in case of doubt, the same should be resolved in favor of the taxpayer, and the fraud surcharge or penalty should not be assessed and demanded.

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STATUTE OF LIMITATIONS -

Having ruled that the petitioner did not willfully make and file false or fraudulent income tax returns, it is clear that the right of the respondent Commissioner of Internal Revenue to assess against the petitioner the questioned deficiency income taxes for the years 1951 and 1952 has already prescribed.

The respondent assessed the deficiency income taxes for the years 1951 and 1952 only on July 3, 1958 (Annex A, Petition for Review), or more than five years from the time the petitioner filed its income tax returns on March 13, 1952 (Exh. B, also marked as Exh. 2, p. 13, BIR rec., CTA No. 565) and March 30, 1953, respectively. (Exh. C, also marked as Exh. 3, p. 20, BIR rec., CTA No. 565). Hence, pursuant to the provisions of Section 331 of the Tax Code, the right to assess the deficiency income taxes corresponding to said years in the amounts of ₱15,576.00 and ₱5,596.50, respectively, is already barred by the statute of limitations, and therefore, there is no income tax deficiency for the said years 1951 and 1952. (Sec. 14, Republic Act No. 1125.)

In resume, we find the petitioner liable for the payment of the amounts of ₱107,846.56, ₱134,033.01 and ₱71,392.82 as deficiency income taxes for the years 1953, 1954 and 1956, respectively, or the total sum of ₱313,272.39, computed as follows:

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Net income as per audited return..........		₱5,193,716.89
Unallowable deductions & additional income:		
Participation of Benguet Consolidated Mining Co. on the net accounts receivable at the end of the year	₱100,120.10	
Depletion overcharged	191,184.19	
Depreciation adjustment	93,862.96	
Total adjustments		385,167.25
Net income as per investigation		₱5,578,884.14
Income tax due thereon		₱1,554,087.56
Less amount already assessed		1,446,241.00
DEFICIENCY TAX DUE		₱ 107,846.56

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Net income as per audit return		₱3,320,307.68
Unallowable deductions & additional income:		
Participation of Benguet Consolidated Mining Co. on the net accounts receivable at the end of the year	₱294,659.90	
Depletion overcharged	158,669.58	
Depreciation adjustment ...	11,878.12	
Miscellaneous expenses	13,481.20	
Total adjustments		478,688.80
Net income as per investigation		₱3,798,996.48
Income tax due thereon		₱1,055,719.01
Less amount already assessed		921,686.00
DEFICIENCY TAX DUE		₱ 134,033.01

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Net income as per audited return		₱11,504,483.97
Unallowable deductions & additional income:		

Depletion overcharged	₱237,386.10	
Miscellaneous expenses	17,590.00	
Total adjustments		254,976.10
Net income as per investigation		₱11,759,460.07
Income tax due thereon		₱ 3,284,648.82
Less amount already assessed		3,213,256.00
DEFICIENCY TAX DUE		₱ 71,392.82

WHEREFORE, in view of the foregoing considerations, petitioner Consolidated Mines, Inc., is hereby ordered to pay to the respondent Commissioner of Internal Revenue the amounts of ₱107,846.56, ₱134,033.01 and ₱71,392.82, as deficiency income taxes for the years 1953, 1954, and 1956, respectively, or the total sum of ₱313,272.39. If not paid in full within thirty (30) days from the date this decision becomes final and executory, the petitioner shall pay a surcharge of five per cent (5%) of the unpaid amount, plus interest at the rate of one per cent (1%) a month, computed from the date this decision becomes final until it is paid.

SO ORDERED.

Manila, May 6, 1961.

AUGUSTO M. LUCIANO
Associate Judge

WE CONCUR:

MARIANO NABLE
Presiding Judge

ROMAN M. UMALI
Associate Judge

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