REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

MANILA GAS CORPORATION,
Petitioner,

versus

Oct. 21/70

CTA CASE NO. 1916

COMMISSIONER OF
INTERNAL REVENUE,
Respondent.

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D E C I S I O N

From a decision of respondent dated July 19, 1967, requiring petitioner to pay the sum of ₱83,534.56, representing deficiency income tax for 1963, inclusive of interest, an appeal was taken to this Court.

The facts, briefly stated, are as follows:

Petitioner, a government-owned and controlled corporation, is a grantee of a franchise (Act No. 2039) to construct, maintain and operate a gas system for the furnishing of gas for heat, lighting and power in the city of Manila and the province of Rizal.

For the year 1963, petitioner filed its franchise tax return declaring therein gross earnings in the amount of ₱3,536,113.42, including the proceeds from the sale of residuals, and paid the corresponding tax thereon in the amount of ₱88,402.84. Petitioner also filed its income tax return for the same year, claiming a deduction for depreciation of its steel cylinders at the rate of 10% per annum.

Under date of July 19, 1967, respondent assessed and demanded from petitioner the sum of ₱83,534.56 as deficiency income tax for 1963, plus interest, computed as follows:

ACR-600307-66/63

Net income per return		₱101,942.13
Add: Unallowable deduction & additional income:		
1. Income from sale of Oil Tar & Industrial Insecticide (not covered by franchise)	₱225,016.66	
2. Depreciation of steel cylinders	10,958.00	₱235,974.66
Net income per investigation.		₱337,916.79
Tax due thereon		₱ 93,375.00
Less: Amount already assessed.		22,583.00
B a l a n c e		₱ 70,792.00
Add: ½ mo. int. fr. 4-16-64 to 4-16-67		12,742.56
TOTAL AMOUNT DUE & COLLECTIBLE.		₱ 83,534.56

On August 21, 1967, petitioner protested the assessment and requested that the same be reconsidered. Said request was granted by respondent in a letter dated October 19, 1967, conditioned on petitioner's execution of a waiver of the defense of prescription. Acceding to the request of respondent, petitioner executed the corresponding waiver. Subsequently, petitioner addressed a letter to respondent containing arguments in support of the request for reconsideration, but respondent denied the same and reiterated his demand for the 1963 deficiency income tax, plus interest. From the said decision, petitioner appealed to this Court.

The issues presented for our determination are as follows:

> 1. Whether or not the income realized from the sale of (residuals) oil tar and industrial insecticide is subject to franchise tax, and, therefore exempt from the payment of income tax; and
>
> 2. Whether or not respondent's disallowance of the deduction claimed by petitioner for depreciation of its steel cylinders at the rate of 10% per annum is justified.

Petitioner claims that the income it realized from the sale of oil tar and industrial insecticide forms part of its gross receipts subject to franchise tax under Sections 9 and 10 of its charter (Act No. 2039) which read:

> "Section 9. The grantee shall annually on the fifth day of January of each year pay to the city of Manila and to the municipalities of the Province of Rizal in which gas is sold, two and one-half per centum of the gross receipts within said city and municipalities, respectively, during the preceding year. Said payment shall be in lieu of all taxes, Insular, provincial and municipal, except taxes on the real estate, buildings, plant, machinery, and other personal property belonging to the grantee.

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"Section 10. The grantee shall keep a record of all gas and other products sold and collections made. The books and accounts of the grantee shall be kept in the city of Manila and shall be subject to inspection and audit by the proper municipal authorities and the Insular Auditor."

Petitioner contends that oil tar and industrial insecticide are by-products resulting from the manufacture of gas, the proceeds from the sales of which are subject to franchise tax under Section 10 of its charter. Accordingly, it is alleged that the proceeds from the sales of said articles are exempt from income tax.

The word "by-products" refers to those materials which in the cultivation or manufacture of any given commodity remain over, and which possess or can be brought to possess a market value of their own (Phil. Manufacturing Co. v. Meer, 76 Phil. 436). Admittedly, the oil tar and industrial insecticide are by-products that result in the process of manufacturing gas as authorized by the charter of petitioner. Petitioner does not manufacture oil tar and industrial insecticide for sale as an independent business. It follows that the sale of said by-products is not taxable independently of petitioner's principal business. (See Macondray v. Sarmiento, 90 Phil. 709; Ah Nam v. City of Manila, 109 Phil.

808.) The proceeds of the sales of such by-products are, therefore, part of petitioner's gross receipts in the operation of its franchise which are subject to franchise tax; hence, exempt from income tax.)

As regards the rate of depreciation applicable to steel cylinders used as containers of gas sold by petitioner, respondent claims that since the estimated economic usefulness of steel cylinders fixed in Bulletin "F" of the U.S. Internal Revenue Service is 25 years, the said steel cylinders should be depreciated at an annual depreciation rate of 4%.

On the other hand, petitioner contends that the depreciation rate of 10% per annum is based upon the literature from the manufacturers of the steel cylinders which requires users of such cylinders to have them tested every ten years because experience shows that several cylinders are no longer fit for use after ten years of use. In view of this instruction of the manufacture of the cylinders the economic usefulness of the cylinders has been estimated at 10 years.

(Section 30(f) of the National Internal Revenue Code allows deduction from gross income of the amount representing depreciation of property used in the trade or business which has an estimated useful life of more than one year. The amount deductible by way of depreciation is that amount which should be set aside for the taxable year in accordance with a reasonable consistent plan whereby the aggregate of the amount so set aside, plus the salvage value, will, at the end of the useful life of the property in business, equal the basis (generally the cost) of the property. (Sec. 105, Rev. Regs. No. 2.)

The Income Tax Regulations (Rev. Regs. No. 2) provides for the methods of computing depreciation allowance as follows:

> Section 109. Method of Computing Depreciation Allowance.—The capital sum to be replaced should be charged off over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and must have due regard to operating conditions during the taxable period. While the burden of proof must rest upon the taxpayer to sustain the deductions taken by him, such deductions must not be disallowed unless shown by clear and convincing evidence to be unreasonable. The reasonableness of any claim for depreciation shall be determined upon the conditions known to exist at the end of the period for which the return is made. If it develops that the useful life of the property will be longer or shorter than the useful life as originally estimated under all the then known facts, the portion of the cost or other basis of the property not already provided for through depreciation allowances should be spread over the remaining useful life of the property as reestimated in the light of the subsequent facts, and depreciation deductions taken accordingly.

The amount of the annual deduction for depreciation is ordinarily dependent upon the expected useful life of the asset. And this is determined in the first instance by the taxpayer himself because of his experience in the use of depreciable property in his business. The determination of the estimated useful life of depreciable property by the taxpayer should not be lightly disregarded unless patently shown to be incorrect. In this case, petitioner estimated that the useful life of said steel cylinders is normally ten years in line with the instructions contained in the literature furnished by the manufacturers, and in view of its experience that several steel cylinders became unserviceable after ten years. On the other hand, respondent relies solely on the estimated useful life of steel cylinders as shown in Bulletin "F" of the U. S. Internal Revenue Service.

It is true that the estimated useful life of property shown in Bulletin "F" is generally conceded to be reasonable as in fact the same has been resorted to and applied in this jurisdiction (see Zamora v. Collector, G.R. Nos. L-15290, L-15280, L-15289 & L-15281, May 31, 1963), but is not conclusive.

> Bulletin "F", issued by the Treasury Department in January, 1931, and revised in January, 1942, lists the probable use-

> ful life of several hundred items. <u>The useful life figures given in the Treasury's table may not be used arbitrarily</u>. The question in every case is one of fact to be determined in the light of the experience of the property under consideration and all other pertinent evidence. The Commissioner will not disturb depreciation deduction unless there is clear and convincing basis for a change. (PH Federal Tax Handbook, 1955 ed., Par. 2011; see also Sec. 109, Rev. Regs. No. 2.)

Petitioner has shown, and respondent has not disputed, the fact that several of such steel cylinders were discarded after ten years, and although some were still serviceable after ten years is no reason why said steel cylinders should all be depreciated for a period in excess of 10 years. Petitioner could not ascertain from the start what cylinders would last 10 years and those which would last more than that period. Again, while a taxpayer is permitted to use different methods of depreciation appropriate to different classes of property, he is required to use a consistent method with regard to each class. (PH Federal Tax Handbook, 1955 ed., Par. 2005.) We find no sufficient justification to sustain respondent as regards the depreciation deduction allowable for said steel cylinders.

In view of the foregoing, the decision appealed from is hereby reversed. Without pronouncement as to costs.

SO ORDERED.

Quezon City, October 31, 1970.

ROMAN M. UMALI
Presiding Judge

WE CONCUR:

ESTANISLAO R. ALVAREZ
Associate Judge

RAMON L. AVANCEÑA
Associate Judge