REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SOCIETE ANONYME ETERNIT,
Petitioner,

versus CTA CASE NO. 1503

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

x - - - - - - - - - - - - - x June 29/68

DECISION

This is a claim for refund of the amount of P8,293.14 paid by petitioner as deficiency income tax and interest for the year 1956.

Petitioner is a nonresident foreign corporation organized and existing under and by virtue of the laws of Belgium, with principal office at Kappelle Op Den Bos, Belgium. It has no agent or place of business in this country.

On April 1, 1950, petitioner entered into an agreement with Eternit Corporation, a domestic corporation with offices at Mandaluyong, Rizal, for the latter to manufacture and sell asbestos cement products in the Philippines under its trademark "Eternit." In accordance with said contract, petitioner undertook to supply Eternit Corporation asbestos fibre for use in the manufacture of said asbestos cement products and to make available for the exclusive use of Eternit Corporation all designs, patents, know-how, processes, patterns and other technical data relative to the manufacture of building products, particularly asbestos cement sheets and roofings. In consideration thereof, Eternit Corporation agreed to pay to petitioner "a royalty equivalent to three percent (3%) of the ex-works invoiced selling prices of all products" manufactured and sold by the former under the contract.

In connection with its agreement to furnish Eternit Corporation with designs, patents, processes, patterns and technical data relative to the manufacture of said products, petitioner established a separate office in Brussels, Belgium, with a manager and technical staff composed of engineers and chemists (pp. 74-75, BIR rec.; Memorandum for the Petitioner, pp. 40, 45-46, CTA rec.). In the operation and management of its Brussels' office, petitioner incurred in 1956 expenses for salaries, cables and telephone, postage, stationary, laboratory and research in the sum of ₱18,061.08 (pp. 2, 58, 78, BIR rec.).

In 1956 petitioner received from Eternit Corporation 3% royalty in the sum of ₱112,481.48 and dividends in the amount of ₱36,325.00, or a gross income of ₱148,806.48, which it reported in its 1956 income tax return, from which it deducted the sum of ₱18,667.47, resulting in a net income of ₱130,139.01, on which it paid a tax of ₱28,439.00 (pp. 1-4, BIR rec.).

Respondent, after investigation, disallowed the deductions in the amount of ₱18,061.08, but allowed an amount of ₱606.99 representing petitioner's expenses corresponding to bank charges paid for the remittance of its income from the Philippines to Belgium, resulting in a deficiency assessment of ₱7,139.00, plus interest in the sum of ₱1,154.14, or a total deficiency income tax of ₱8,293.14 (p. 46, BIR rec.), which petitioner paid under protest on April 5, 1962.

On June 1, 1962, petitioner filed with respondent its claim for refund of the sum of ₱8,293.14 alleging that the payment of said amount was illegally or erroneously made. Before a decision could be rendered by respondent on petitioner's claim for refund, petitioner filed its petition for review with this Court.

The only issue to be resolved in this case is whether or not the expenses in the total amount of ₱18,061.08 incurred and paid in the operation and management of petitioner's office in Brussels are deductible from its gross income.

Petitioner contends that before its amendment by Republic Act No. 2343, Section 24 of the National Internal Revenue Code imposed a tax upon net income and, therefore, recognized the deductibility of expenses incurred or paid by it in Brussels which were directly connected with the production of income realized within the Philippines by a nonresident foreign corporation. It cites Sections 46 and 37 of the said Code to buttress its contention.

On the other hand, respondent, invoking Section 54 of the same Code, before its amendment by Republic Act No. 2343, contends that a non-resident foreign corporation not engaged in trade or business in the Philippines, of which petitioner is one, is taxed not on the basis of its net income but on its gross income, or the entire amount received from within the Philippines without any deduction. Consequently, it is urged that the questioned expenses are not deductible from petitioner's gross income for the purpose of computing the tax.

The pertinent provisions of the National Internal Revenue Code upon which the respective contentions of the parties are predicated, are as follows:

SEC. 24. Rate of tax on corporations.—There shall be levied, assessed, collected and paid annually upon the total net income received in the preceding taxable year from all sources by every corporation organized in, or existing under the laws of the Philippines, no matter how created or organized, but not including duly registered general co-partnerships (compañías colectivas), a tax upon such income equal to the sum of the following:

x x x x x

Twenty-eight per centum upon the amount by which such total net income exceeds one hundred thousand pesos; and a like tax shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding taxable year from all sources within the Philippines by every corporation organized, authorized, or existing under the laws of any foreign country: x x x (Underscoring supplied; as amended by Republic Act 1148)

SEC. 30. Deductions from gross income. - In computing net income there shall be allowed as deductions -

(a) Expenses:

x x x x

(2) Expenses allowable to nonresident alien individuals and foreign corporations. - In the case of a nonresident alien individual or a foreign corporation, the expenses deductible are the necessary expenses paid or incurred in carrying on any business or trade conducted within the Philippines exclusively. (Underlining supplied.)

SEC. 37. Income from sources within the Philippines. - (a) Gross income from sources within the Philippines. -

x x x x

(b) _Net income from sources in the Philippines. - From the items of gross income specified in subsection (a) of this section there shall be deducted the expenses, losses, and other deductions_ properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as net income from sources within the Philippines. x x x (Underscoring supplied.)

SEC. 46. _Corporation returns._ - (a) _Requirement. - Every corporation, subject to the tax herein imposed, shall render, in duplicate, a true and accurate return of its annual net income_ in the manner and form prescribed by the Collector of Internal Revenue with the approval of the Secretary of Finance, and containing such facts, data, and information as are appropriate and in the opinion of the Collector of Internal Revenue necessary to determine the correctness of the net income returned and to carry out the provisions of this Title. The return shall be filed by the president, vice-president, or other principal officer, and shall be sworn to by such officer and by the treasurer or assistant treasurer. (Underscoring supplied.)

SEC. 54. _Payment of corporation income tax at source._ - In the case of foreign corporations subject to taxation under this Title not engaged in trade or business within the Philippines and not having any office or place of business therein, there shall be deducted and withheld at the source in the same manner and upon the same items of income as is provided in Section fifty-three a tax equal to twenty-four _per centum_ thereof, and such tax shall be returned and paid in the same manner and subject to the same conditions as provided in that section. (As amended by Republic Act No. 600.)

Section 24, before its amendment by Republic Act No. 2343, imposed a corporate tax upon the net income of domestic and foreign corporations. As regards foreign corporations, the law did not make any distinction between a resident foreign corporation and a nonresident foreign corporation not engaged in business or trade in the Philippines (Alexander Howden & Co., et al. v. Comm. of Int. Rev., G.R. No. L-19392, April 14, 1965; see also British Traders' Insurance Co., Ltd. v. Comm. of Int. Rev., G.R. No. L-20501, April 30, 1965). Neither this nor any other related provisions (Sections 37 and 46) of the Code imposed the corporate tax upon gross income. (It follows that a nonresident foreign corporation not engaged in trade or business like petitioner was taxable, prior to the effectivity of Republic Act No. 2343, on its net income. In fact, the corporate tax imposed in Section 24 had been previously computed by respondent on net income, that is, only after deducting the general expenses from gross income) (Alexander Howden & Co., et al. v. The Coll. of Int. Rev., Manila Civil Case No. 22848, Decision, Nov. 24, 1961, aff'd. in Alexander Howden & Co., et al., op. cit.).

The imposition of the corporate tax upon the net income of a "foreign corporation," which as aforesaid includes a resident or nonresident foreign corporation, becomes more evident considering Section 30(a)(2) which permits deductibility from gross income of necessary expenses paid or incurred in carrying on any business or trade conducted within the Philippines exclusively. The conclusion that the tax on a nonresident foreign corporation was imposable upon its gross income under Section 54 of the National Internal Revenue Code cannot now be drawn. It is to be noted that despite the existence of a similar provision (Section 237) in the U. S. Internal Revenue Code of 1918, which is substantially similar to Section 54 of our Revenue Code, the tax upon a nonresident foreign corporation in the United States was nevertheless imposed upon the net income thereof, that is, after allowing deductions, and not upon its gross income (Kompagni v. Comm., 19 BTA 294, 298). It is only under the U. S. Revenue Code of 1936 to 1954 when nonresident foreign corporations began to be taxed on their gross income consisting of interest, dividends, salaries, etc., or other fixed or determinable annual or periodical income (Vahram Chimchirian v. Comm., 42 BTA 1437, 1440; Secs. 45.16 & 45.24, Mertens, Law on Federal Income Taxation, Vol. 8, Chap. 45, pp. 24 et seq. and 55 et. seq.). Section 881 of the U. S. Revenue Code of 1954, a cognate provision of Section 24 of our Revenue Code, as now amended by Republic Act No. 2343, reads:

> SEC. 881 [1954 Code] (a) Imposition of Tax. - In the case of every foreign corporation not engaged in trade or business within the United States, there is hereby imposed for each taxable year, in lieu of the taxes imposed by Section 11, a tax of 30 percent of the amount received from sources within the United States as interest (except interest on deposits with persons carrying on the banking business), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income (including amounts described in section 631 (b) and (c) which are considered to be gains from the sale or exchange of capital assets). (CCH, Vol. 4, 1958 Ed., Sec. 4171; underlining supplied.)

Under this law, a nonresident foreign corporation is taxed upon the "amount received," which means "gross income" (CCH, ibid., Sec. 4172A; Mertens, op. cit., Sec. 45.24, Chap. 45, p. 55).

Coming now to the question at issue of whether or not the expenses claimed by petitioner may be allowed as deduction pursuant to Section 30(a)(2) of the Revenue Code, it is necessary to restate the rule that the taxpayer must show that its claimed deductions clearly come within the language of the law, since allowances of deductions, like exemptions, are matters of legislative grace (Mertens, op. cit., Vol. 4, 1958 Ed., Sec. 25.03, Chap. 25, pp. 7, 8-9; Mertens, ibid., Vol. 1, 1956 Ed., Sec. 3.09, Chap. 3, pp. 15-16; Capitol Indemnity Insurance Co. v. Comm., 25 BTA 147, 150).

In this case, petitioner has no agent or place of business in the Philippines. At best, it is merely engaged in activities involving the collection of royalties as a result of the manufacture of its patented products, the authorized use of its tradename by Eternit Corporation, and the receipt of dividends from its stockholdings in the latter. But mere receipt of income from royalties and dividends are insufficient activities by themselves so as to consider petitioner as being engaged in business or trade in the Philippines, and this is so irrespective of the continuity, repetition, regularity or frequency of these activities. (See McCoach v. Minehill, 57 L. ed. 842, 847, cited in 2 PH Sec. 16, 603B; Higgins v. Comm., 312 U. S. 212, 85 L. ed. 783; Mertens, op. cit., Vol. 4, 1960 Rev. Ed., Sec. 25.08, Chap. 25, p. 20.) Since petitioner is not engaged in business or trade in the Philippines, it can not be said that it had paid or incurred expenses in carrying on a business or trade in the Philippines exclusively in 1956. As a matter of fact, the expenses being claimed by petitioner as deductions were admittedly paid or incurred in Brussels in 1956. Therefore, these expenses, not having been paid or incurred in carrying on a business or trade conducted within the Philippines, are not allowable deductions from its gross income pursuant to Section 30(a)(2) of the Revenue Code.)

While it is true that the expenses were directly connected with earning the dividends and royalties received from a Philippine corporation, this is not enough justification for their allowance. The circumstance that the expenditures were incurred or paid pursuant to a contractual obligation does not also suffice to make such expenses deductible (Capital Indemnity Insurance Co. v. Comm., op. cit.) because the law clearly and unequivocably limits deductions only to those "necessary expenses paid or incurred in carrying on any business or trade conducted within the Philippines exclusively." (Sec. 30/a7/27, ibid.) Consequently, we are of the opinion and so hold that the disallowance of said expenses by respondent is proper and the assessment against petitioner of the 1956 deficiency corporate income tax, plus interest, in the total amount of ₱8,293.14 is in order.

DECISION -
CTA CASE NO. 1503

WHEREFORE, the herein petition for review is hereby dismissed.

SO ORDERED.

Quezon City, June 29, 1968.

ROMAN M. UMALI
Presiding Judge

WE CONCUR:

ESTANISLAO R. ALVAREZ
Associate Judge

RAMON L. AVANCEÑA
Associate Judge