REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

JOHN T. HICKS,
Petitioner,

- versus -

Oct. 19, 1955

C.T.A. CASE NO. 38

COLLECTOR OF INTERNAL REVENUE,
Respondent.

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DECISION

This is an appeal interposed by the petitioner John T. Hicks, from a decision of the respondent Collector of Internal Revenue assessing and collecting a deficiency income tax in the amount of ₱1,577.56, inclusive of penalties, on the income tax return filed by petitioner for the calendar year 1952. The deficiency income tax assessment in question was the result of a disallowance made by the respondent Collector of Internal Revenue of alleged entertainment or representation expenses in the sum of ₱3,116.87 claimed as a deduction by the petitioner in the computation of his net income for the calendar year 1952 as appearing in his income tax return (Exhibit A, petitioner; Exhibit 3, respondent.)

The pertinent facts of the case as gathered from the pleadings of the parties and evidence introduced during the trial are as follows: that the petitioner, John T. Hicks, is General Manager of the Philippine branch of Liggett & Myers Tobacco Co., a corporation organized in the United States doing business in the Philippines; that aside from his position of General Manager, the petitioner also acts as Far East Sales Manager of the same company; that in his income tax return for the year 1952, the petitioner returned as his gross income the following: dividends received in the amount of ₱1,080.00, regular salary received from Liggett & Myers Tobacco Co. in the sum of ₱42,466.68, and bonus received from the same corporation in the amount of ₱16,000.00; that for the same period, the petitioner claimed as deduction, among others, the sum of ₱3,116.87, allegedly representing entertainment and representation expenses; that the employer of petitioner allows him entertainment expenses for representation in the sum of ₱2,000.00 per annum, and that this amount is spent for entertainment in specific cases, as when the company pays for a customer's hotel bills while in Manila; that during the year 1952, actual expenses paid and charged to this account of the company for entertainment was in the sum of ₱1,912.19, which was incurred upon petitioner's authority or by his assistant; that the petitioner also entertains customers or prospective customers of the company, by taking them out to lunch or entertaining them at his home and/or in various clubs to which petitioner is affiliated; that in 1952, his entertainment expenses of this nature amounted to approximately ₱5,000.00, but he claimed as deduction in his income tax return only the sum of ₱3,116.87, consisting of club dues and chits in payment of refreshments and others at the Manila Polo Club, Manila Golf Club, Army & Navy Club, Baguio Country Club and Elks Club; that in the latter case, no reimbursement by the corporation is allowed because entertainment expenses of this nature are of an indefinite nature; that there is no contract of any kind between petitioner and his employer, the Liggett & Myers Tobacco Co., as regards entertainment or representation expense; that such matter was never taken up by petitioner with the board of directors of the corporation; that he has all along considered these disbursements as his own, incurred voluntarily, in his desire to enhance the chances of attaining a larger income for the corporation by increase of sales and thereby increase the possibilities of his receiving a bonus therefrom; that the bonus paid to and received by the petitioner in 1952 was for business done in 1951; that there was no definite arrangement by the corporation as to the giving of bonuses in relation to the sales made but on the other hand any bonus given by the corporation is determined upon the net profits earned by the company as a whole; and that, of the bonuses set aside every year by the corporation, 50% thereof is paid to the directors and officers and the other 50% is distributed by and at the discretion of the president to certain employees considering various factors, such as sales and performance during the year.

The respondent disallowed this deduction for entertainment expenses allegedly incurred by petitioner on the ground that the petitioner was a mere salaried employee of the company (Exhibit "B") and therefore determined a deficiency income tax for 1952. The deficiency tax having been paid and a claim for refund thereof duly filed with the respondent, the petitioner has asked this Court, in his petition for review, to order the refund of the income tax paid upon an allegedly erroneous deficiency assessment.

The entertainment expenses involved herein is governed by section 30 (a) (1) of our National Internal Revenue Code, which allows as deduction in computing net income: "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business". By way of observation, we note that the foregoing provision is identical to section 23 (a) (1) of the United States Internal Revenue Code of 1939, so that the recognized application or interpretation of this provision in the latter jurisdiction may be used as a guide in our Court in proper cases.

Expenses which are described as being "ordinary and necessary" generally contemplate expenses which are directly connected with and proximately resulting from carrying on the business and must be shown to be appropriate and helpful in the development of the taxpayer's business for the acquisition or pursuit of income or profit (Deputy v. Du Pont, 308 U.S. 488, 84 L Ed 416; Welch v. Helvering, 290 U.S. 111, 78 L Ed 212). In connection with this case, it may be stated in passing, that it has become a business, and to a certain extent a professional practice to entertain actual or prospective customers or clients. Since expenses of this nature generally consist of a mixture of personal and business purposes, whether or not such expenditures will be allowed, will depend upon the factor of the necessity of such expenses to earn the income, or that direct business benefits would be derived from such expenditures, or whether the expenses have some definite reasonable purpose connected with the business in hand and reasonably calculated to accomplish the end sought (see 4 Mertens, Law of Federal Income Taxation, 467-468). In this instance, the burden of proof is on the taxpayer to show that such expenditures were primarily business rather than personal expense.

In the case at bar, it must be noted that the petitioner is an employee drawing a fixed salary and that the club dues and other entertainment expenses were incurred voluntarily by the petitioner with the expectation that it would enhance the sales of the corporation. For such outlays, it was his anticipation that the increase of sales would in turn improve his record and performance as Branch and Sales Manager and in that way ultimately benefit him, as he would be due to receive some bonus thereby.

However, as we have previously observed, the bonus, if any, for which the petitioner was anticipating, was reckoned not in relation to the quantity or sales performance of the corporation within his area. On the contrary, the bonus was yet to be fixed in relation to the net profit of the corporation as a whole and further depended upon a distribution to be made by the corporation's president, who had sole discretion thereto. Moreover, the petitioner has even failed to identify or name the persons or customers who were entertained by him so as to show a business purpose or benefit to be derived proximately from such expenditures. In such respect, the club dues and other entertainment expenses, in issue here, did not and has not been shown to have a close or direct relation to the acquisition of petitioner's dividends and salary nor of any past or anticipated bonus—if at all, the relation is quite remote.

> "The petitioner claims the right to deduct as ordinary and necessary business expenses a total of $1,188.11 paid as dues, contributions, and entertainment expenses to a golf country club, a city athletic club, various civic and political clubs, and two lodges. . . . .
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> " . . . . Whether or not a particular expenditure is a deductible business expense turns on the facts of each case and the burden of proof is on the petitioner to show that such expenditures were primarily business rather than personal expenses. We do not think the burden of proof is met by the petitioner's argument that in general, membership in social, political, and fraternal organizations is helpful in obtaining clients through con-

> tacts made thereby or citing of one instance of gaining a client through acquaintance made at a political club. No evidence has been introduced to show that any part or all of the expenditures in question were so closely related to the conduct of the petitioner's business as to have been appropriate, helpful, usual or necessary. It is noted that in cases where expenditures of a social nature have been held to be deductible business expenses proof was presented to show that such expenditures had a direct relation to the conduct of a business or the business benefits expected." (Boehm v. Commissioner (1937) 35 BTA 1106)

Furthermore, we specially note that the entertainment expenses here involved, were incurred by the petitioner on his volition. As a matter of fact, Liggett & Myers Tobacco Co., had set aside an annual sum of ₱2,000.00 for this purpose and any such excess entertainment expenses, if allowable at all, were the ordinary and necessary expenses of petitioner's employer and not the expenses of earning his salary as Sales Manager or Branch General Manager (Andrew Jergens v. Commissioner, 17 TC 806). Hence, where the entertainment expenses are borne by an employee, his deduction must be predicated upon a showing that the expense was a necessary incident of his employment or of the earning of his salary or wages (Abraham v. Commissioner (1947) 9 TC 222).

Without necessarily deciding on such point, we believe that the case at bar is different from other instances in which entertainment expenses had been allowed, because in those cases the entertainment constituted part of the duties assigned to the employee, for which no reimbursement was provided by the employer (Schmidlapp v. Commissioner (1938) 96 F 2d 680; Abraham v. Commissioner, supra); or that the entertainment was a necessary incident to the business or acquisition of the income returned (James F. Coleman, (1926) 3 BTA 835; Dickenson v. Commissioner (1927) 8 BTA 722; Joe May v. Commissioner (1939) 39 BTA 946; Cohan v. Commissioner (1930) 39 F 2d 540).

In conclusion, we find that the club dues and other entertainment expenses paid and incurred by the petitioner in 1952, do not constitute appropriate, helpful, usual or necessary expenditures for the acquisition of his income consisting of salaries, bonus and dividends nor directly connected with the realization thereof as to be treated as deductible "ordinary and necessary" expenses in computing petitioner's income and therefore hold that the respondent properly disallowed said entertainment expenses claimed as a deduction by the petitioner.

FOR ALL THE FOREGOING, we find and so hold as proper, the determination of deficiency income tax by the respondent upon the petitioner's income tax return for 1952 in the sum of ₱1,577.56, including penalties, and therefore the petition for review should be as it is hereby dismissed, with costs against petitioner.

SO ORDERED.

Manila, Philippines, October 19, 1955.

AUGUSTO M. LUCIANO
Associate Judge

We concur:

MARIANO NABLE
Presiding Judge

ROMAN M. UMALI
Associate Judge

-116