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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SMITH KLINE & FRENCH OVERSEAS
CO. (Philippine Branch),
Petitioner,

- versus - C.T.A. CASE NO. 2591

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.
x - - - - - - - - - - - - - - - - x

3/21/80

D E C I S I O N

Suit brought by petitioner Smith Kline & French Overseas Co. (Philippine Branch) for recovery of the amount of ₱324,255.00 as alleged overpaid income tax for 1971 after no action was taken by respondent Commissioner of Internal Revenue on its claim for refund.

As borne out by the pleadings submitted by the parties and records of the Bureau of Internal Revenue pertaining to this case, it appears that petitioner is a resident foreign corporation organized and existing under the laws of the State of Delaware, U.S.A., and duly licensed to transact business in the Philippines. It is engaged in the importation, manufacture and sale of drugs, pharmaceuticals and chemicals. Petitioner is a Philippine branch of a United States corporation bearing the same name, with home office in Philadelphia, Pennsylvania, U.S.A.

On April 17, 1972, petitioner filed its income tax return for taxable year 1971 declaring therein a net taxable income of ₱1,489,277.00 and paid an income tax as reflected thereon in the amount of ₱511,246.80 (Exh. "A", p. 55, BIR records) as follows:

OR No.	Date	Amount
6000077 E	4-17-72	₱255,623.50
6000798 E	8-14-72	9,947.20
Tax Debit Memo Ref. No. 00079	8-11-72	245,676.30
		₱511,247.00

(Exhs. "B", "B-1" & "C", pp. 62-63, BIR records.) Among the deductions claimed by petitioner from gross income is the amount of ₱501,040.00, the equivalent of $77,060.00 which was certified by the Treasurer of the main office as its share in 1971 of the Philippine operations in home office unallocated overhead expenses, in accordance with the "service agreement" between petitioner and the head office. (Exh. "2", p. 65, BIR records.)

Subsequently, petitioner amended its income tax return for 1971 reflecting thereon the sum of ₱1,427,484.00 ($219,547.00) as its share in home office unallocated overhead expenses, resulting in a reduced income tax liability of ₱186,992.00 and showing an overpayment of ₱324,255.00. (Exh. "D", pp. 7-9, BIR records.) The overpayment arose from the adjustment of petitioner's deduction from gross income of its share in the home office unallocated overhead expenses of ₱501,040.00, as shown in its original return, to ₱1,427,484.00. It appears that sometime in October, 1972, petitioner received from Peat, Marwick, Mitchell & Co., the corporation's international independent auditors, an authenticated certification that the Philippine branch's (or petitioner's) share in home office unallocated overhead expense for the year ended December 31, 1971 amounted to $219,547.00 which is equivalent to ₱1,427,484.00. (Exhs. "G" & "G-2", p. 4, BIR records.)

On March 1, 1973, petitioner filed with respondent, together with the amended income tax return for 1971, a formal claim for the refund of the amount of ₱324,255.00, which represents the difference between the tax previously paid of ₱511,247.00 and the tax liability of ₱186,992.00, computed on the basis of the deduction of petitioner's share of home office overhead expense of ₱1,427,484.00. (Exh. "E", p. 10, BIR records.) Since no action was taken by respondent on its claim for refund, petitioner instituted the instant appeal with this Court on April 2, 1974.

Is petitioner legally entitled to the refund or tax credit of the amount of ₱324,255.00 as overpaid or erroneously paid income tax for the year 1971?

There is no question of, and respondent does not quarrel with, the right of petitioner herein, as a resident foreign corporation transacting business in the Philippines, to deduct from its gross income "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." (See Sec. 37(b), National Internal Revenue Code). And Section 160 of Revenue Regulations No. 2 (Income Tax Regulations), explaining in detail how the "other deductions which cannot definitely be allocated to some item or class of gross income" are to be apportioned, prescribes:

> "Sec. 160. Apportionment of deductions.- From the items specified in section 37(a) as being derived specifically from sources within the Philippines there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any other expenses, losses or deductions which can not definitely be allocated to some item or class of gross income. The remainder shall be included in full as net income from sources within the Philippines. The ratable part is based upon the ratio of gross income from sources within the Philippines to the total gross income.
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> Example: A nonresident alien individual whose taxable year is the calendar year, derived gross income from all sources for 1939 of ₱180,000, including therein:

Interest on bonds of a domestic corporation ----------------------	₱ 9,000
Dividends on stock of a domestic corporation ----------------------	4,000
Royalty for the use of patents within the Philippines -----------	12,000
Gain from sale of real property located within the Philippines ---	11,000
Total ----------------	₱36,000

that is, one-fifth of the total gross income was from sources within the Philippines, The remainder of the gross income was from sources without the Philippines, determined under section 37(c).

The expenses of the taxpayer for the year amounted to ₱78,000. Of these expenses the amount of ₱8,000 is properly allocated to income from sources within the Philippines and the amount of ₱40,000 is properly allocated to income from sources without the Philippines.

The remainder of the expense, ₱30,000, cannot be definitely allocated to any class of income. A ratable part thereof, based upon the relation of gross income from sources within the Philippines to the total gross income, shall be deducted in computing net income from sources within the Philippines. Thus, there are deducted from the ₱36,000 of gross income from sources within the Philippines expenses amounting to ₱14,000 (representing ₱8,000 properly apportioned to the income from sources within the Philippines and ₱6,000, a ratable part /one fifth/ of the expenses which could not be allocated to any item or class of gross income). The remainder, ₱22,000, is the net income from sources within the Philippines.

Thus, expenditures made by a foreign corporation in conducting business are deductible in computing its taxable income from sources within the Philippines when allocable to the production of income from sources within the Philippines or where a ratable part of the general expenditures is apportioned to income within the Philippines. The net income of a resident foreign corporation, like petitioner herein, is therefore determined by deducting from the items of gross income specified in Section 37(a) of the National Internal Revenue Code treated as income from sources within the Philippines, 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, is included in full as net income from sources within the Philippines. (Sec. 37(b), National Internal Revenue Code.) This has already been explained by this Court in Ginn & Co. vs. Commissioner of Internal Revenue, CTA Case No. 674, May 21, 1963, where the right of a resident foreign corporation to deduct from gross income its share of home office overhead expenses allocable to income from the Philippines was sustained.

The collision of the parties occurs however at the proposition of whether petitioner is entitled to claim as deduction from gross income the amount of ₱501,040.00 ($77,060.00) or the sum of ₱1,427,484.00 ($219,547.00) as its share in the home office unallocated overhead expenses for the year ended December 31, 1971.

Petitioner contends that its share of the home office unallocated overhead expenses is ₱1,427,484.00 as determined by its international independent auditors on the basis of the percentage of Philippine gross income to worldwide gross income of the corporation, pursuant to Section 37(b), supra, as implemented by Section 160 of Revenue Regulations No. 2, supra. To substantiate the correctness of said amount, petitioner submitted as Exhibit "G", p. 4, BIR records, the statement of the corporation's international auditors that since its gross income from the Philippines for the year ended December 31, 1971 was ₱7,143,155.00 ($1,098,617.00) while the overall gross income of the corporation as a whole was $6,891,052.00, petitioner's share of the home office unallocated overhead expenses amounted to ₱1,427,484.00 ($219,547.00).

On the other hand, respondent submits that petitioner's deductible share in the home office unallocated overhead expenses is only ₱501,040.00 since said amount was arrived at pursuant to the "service agreement" executed by and between petitioner and its home office. Respondent also contends that petitioner has not presented evidence showing that its home office expenses chargeable to Philippine operations is more than ₱501,040.00.

The contention of respondent that petitioner's share in the home office unallocated overhead expenses is only ₱501,040.00 since this was the amount fixed in the "service agreement" is without merit. The fact that such was the amount charged against petitioner by the main office as its share of the home office unallocated overhead expenses is no reason why it cannot claim as deduction the amount allowed by the law. As aptly stated by petitioner:

> "A close scrutiny of the treasurer's certification indicates that it is dated January 11, 1972. The year end of both petitioner and the home office is the same - December 31, 1971. From these facts, it is evident that when the treasurer issued the certification on January 11, 1972, there were yet no audited financial statements of both petitioner and the home office, since it is of common knowledge that audited financial statements are generally completed 3 or 4 months after the close of the accounting period. This is the reason why corporate taxpayers are given up to the 15th day of the 4th month after the close of the taxable year within which to file their income tax returns accompanied with audited financial statements. There being no financial statements yet when the certification was issued on January 11, 1972, the treasurer could not have correctly computed petitioner's share in home office overhead expenses in accordance with the gross income formula prescribed in Section 160 of the Regulations, since he was not in possession of all the necessary figures or information for the computation, such as petitioner's 1971 gross income, wordwide gross income, and home office unallocated overhead expenses. These figures became available only after the audited financial statements were completed. If at all, therefore, what the treasurer certified to on January 11, 1972 as having been charged by home office to petitioner as the latter's share, was a mere estimate, which did not necessarily reflect the correct and final ratable share of petitioner.

> "Moreover, an absurd and unreasonable consequence would result from respondent's position that since petitioner had already previously deducted $77,060 (₱501,040) which was certified by the home office treasurer, petitioner can no longer claim more than the said amount. It is absurd and unreasonable because it completely would deny to a taxpayer an opportunity to correct an obvious error that causes it damage or prejudice. This has never been the intention of the law. In fact, it is a well accepted practice among corporate taxpayers to file "tentative" tax returns and financial statements just to beat the tax filing deadline, where the statements are not yet completed as of the due date. A final or amended return is later filed. This is to afford such taxpayers the opportunity to correct whatever errors may have been committed in rushing the statements and returns in an attempt to beat the deadline. In fact, even without indicating that the returns and statements filed are tentative, a taxpayer can always amend such returns and statements in order to correct whatever error may have been committed or in order to reflect the true and correct figures. The fact therefore, that the home office treasurer had previously certified a certain amount as petitioner's share, and that petitioner has previously claimed the same as deduction does not mean that petitioner can no longer correct the same if it turns out to be erroneous." (See Memorandum for Petitioner, pp. 37-38, CTA rec.).

Even more, a tax being a forced charge, imposition, or contribution, it operates in invitum, and is in no way dependent upon the will or contractual assent, express or implied, of the persons taxed. (51 Am. Jur. 38-39.) It is exacted pursuant to legislative authority in the exercise of the taxing power. (Id. pp. 71-75.) The question therefore as to who shall pay any given tax and what shall be the basis thereof are determined by law, the operation of which can not be affected by the provisions of a contract to which the Government is not a party. This is of course without prejudice to the right, if any, of a party to the agreement to demand reimbursement from the other party. But such right of reimbursement is independent of, and foreign to, the right of the Government to collect the tax in the manner and under the conditions prescribed by law. (Finley J. Gibbs vs. Collector of Internal Revenue, L-14166, Collector of Internal Revenue vs. Finley Gibbs, L-14320, April 28, 1962, 114 Phil. 1105.) Since the tax and the obligation to pay the same are all created by statute, so are its amount and basis governed by statute, we see no reason why petitioner cannot legally claim as deduction from its gross income the sum of ₱1,427,484.00 as its ratable share in the home office unallocated expenses for taxable year 1971 which is the correct amount it is legitimately entitled to claim under the law.

We likewise find the argument of respondent that petitioner has not submitted evidence showing that its home office expenses chargeable to Philippine operations is more than ₱501,040.00 without merit. As indicated earlier, the statement of petitioner's share of home office unallocated overhead expenses for the year ended December 31, 1971, certified to by Peat, Marwick, Mitchell & Co., the corporation's international independent auditors, was submitted by petitioner as evidence, marked and admitted as Exhibits "G" and "G-2". (pp. 4-5, BIR records.) Said statement was authenticated by Consul Vicente G. Reyes of the Republic of the Philippines in and for the Consular District of New York, U.S.A. (Exh. "G-1", p. 6, BIR rec.). And the facts and figures declared and shown in the said statement have never been questioned or disputed by respondent. We are therefore of the persuasion that the evidence presented more than sufficiently prove that the amount of ₱1,427,484.00 represented petitioner's correct 1971 ratable share in the home office unallocated expenses, the same having been computed in accordance with the gross income formula prescribed in Section 160 of Revenue Regulations No. 2. Accordingly, under Section 37(e) of the National Internal Revenue Code, in relation to Section 160 of Revenue Regulations No. 2, petitioner has the right to claim the amount of ₱1,427,484.00 as deduction from its gross income for taxable year 1971. Petitioner having amended its 1971 income tax return in order to claim the said amount as deduction, it is therefore entitled to the refund of the amount of ₱324,255.00 as overpaid income tax for the year 1971.

WHEREFORE, respondent Commissioner of Internal Revenue is hereby ordered to refund to, or grant a tax credit in favor of, petitioner Smith Kline & French Overseas Co. (Philippine Branch) the amount of ₱324,255.00. Without pronouncement as to costs.

SO ORDERED.

Quezon City, Metro Manila, March 21, 1980.

Amante Filler
AMANTE FILLER
Acting Presiding Judge

I CONCUR:

CONSTANTE C. ROAQUIN
Associate Judge