REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

V. E. LEDNICKY and
MARIA VALERO LEDNICKY,
Petitioners,

- versus -

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

C. T. A.
CASE NO. 783

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DECISION

This is a claim filed by the spouses Victor E. Lednicky and Maria Valero Lednicky for the refund of income tax in the amount of ₱90,520.75 allegedly overpaid for the year 1957.

Petitioners, husband and wife and American citizens, are residents of the Philippines. On February 28, 1958, they filed their joint income tax return for the year 1957, declaring therein a taxable income of ₱519,548.41 and an income tax thereon in the amount of ₱215,954.20. The sum of ₱19,154.55 was withheld at source (Exh. B). The income tax still due in the amount of ₱196,800.00 was paid by them in two equal installments on May 8 and August 7, 1958 (Exh. T). In their return which was made on the basis of actual receipts and payments, they did not elect the tax credit provisions of Section 30 (c)(3)(B) of the National Internal Revenue Code.

On March 19, 1959, petitioners filed an amended income tax return (Exh. T) declaring therein a taxable income of ₱328,812.61. The decrease in the amount subject to tax resulted from the claims for deductions of ₱186,924.74 and ₱3,811.06 representing income tax and deficiency interest, respectively, paid to the United States Government in 1957 plus banking charges, commission and miscellaneous expenses in remitting payments of said U.S. income tax, through the First National City Bank of New York, Manila, to the U.S. District Director of Internal Revenue in Baltimore, Maryland, U.S.A., computed as follows:

1956 US income tax paid on Sept. 5, 1957	$46,824.20
1957 estimated US income tax paid on Sept. 5, 1957	45,912.10
Deficiency interest paid on Oct. 21, 1957 on:	
Underestimated 1956 US income tax	774.89
Late payment 1956 US income tax	1,113.52
Total	94,624.71
Converted to Philippine Currency at ₱2.015 per $1.00	₱190,668.79
Plus stamps, bank commission, etc.	67.01
Total in Philippine Currency . .	₱190,735.80

which petitioners did not include in their original income tax return. Petitioners had no income from sources outside the Philippines. The amended return showed an overpayment of ₱90,520.75 which petitioners asked to be refunded to them on March 19, 1959. Not receiving respondent's decision on their claim for refund, petitioners instituted the instant action on April 28, 1960 under Section 306 of the National

Internal Revenue Code.

The main issue to be resolved in this case is whether or not petitioners may claim as deduction in their Philippine income tax return for the year 1957 the amount paid by them in said year as U. S. Federal income taxes, together with deficiency interest thereon, on income earned by them in the Philippines during the same year.

Before resolving the main issue, we are constrained to dispose of a question on which respondent focused the attention of this Court. He maintains that the payment by petitioners of estimated U.S. Federal income tax for the year 1957 in the amount of $45,912.10, reported in Form 1040-ES of the U.S. Treasury Department, should not be considered payment, but should be treated as a deposit to answer for taxes that would become due.

The U.S. Revenue Code of 1954 provides (Section 6015) for a system of collecting income tax whereby taxpayers pay their income tax during the year the corresponding income is earned. The system applies, in the case of individuals, to those whose income tax will not be satisfied through withholding by employers, such as (1) when an individual has income from a business or profession, dividends, interest or rent, (2) when his compensation is not subject to withholding, and (3) when his income is so large that it is subject to tax at rates higher than those used in the withholding tables. Such individuals are required to file a declaration (Form 1040-ES) at the beginning of the year showing the amount of their tax liability which will not be satisfied by withholding. Payment of the estimated tax maybe made when the declaration is filed, or in four equal installments (Sec. 6073). Payment of any installment of the estimated tax is considered a payment of the income tax for the year for which the estimate is made (Sec. 6315). Necessary adjustments are made when the final return is filed, that is, if an individual has overestimated the tax, he is entitled to a refund or tax credit (Sec. 6201(a)(3); but when the tax is underestimated the taxpayer is liable for the deficiency, plus penalties (Sec. 6654; 1956 PH SS 3901-3931).

Section 6315 of the U.S. Internal Revenue Code of 1954 expressly considers the payment of estimated income tax or any installment thereof as payment (rather than a mere deposit). Respondent, however, cited Surigao Consolidated Mining Co., Inc. vs. Collector of Internal Revenue, Civil Case No. 4770, July 16, 1958, where this Court ruled that payment to the Government to cover mining taxes, the amount of which was uncertain, made to avoid the payment of interest and penalties was merely a deposit and not payment of tax. The above-cited case has no application to the case at bar, not only because it involves an interpretation of a different provision of law, but also because even from the very beginning the taxpayer in said case made it clear that the payment was merely a deposit.

It appearing that petitioners filed their U.S. Declaration of Estimated Tax for 1957 (Exh. F-1); that they filed Applications For Purchase of Foreign Exchange (Exhs. J, K and L); that they were issued Central Bank licenses to Buy Foreign Exchange (Exhs. M and N); and that the amount of $94,624.71, which includes the sum of $45,912.10 in question, was actually remitted through the First National City Bank of New York (*See* Exhs. O, P, Q and R), without any intimation by petitioners that the remittance was being made as a mere deposit to cover the 1957 U.S. income tax, we are constrained to rule that the sum of $45,912.10 constitutes payment of petitioners' U.S. income tax, not a mere deposit.

We come now to the main issue.

Petitioners claim the deduction in question under Section 30 (c) (1) (B) of the Revenue Code, quoted hereunder:

> "SEC. 30. *Deduction from gross income*. - In computing net income there shall be allowed as deductions -
>
> (c) Taxes:
>
> (1) In general - Taxes paid or accrued within the taxable year, except -
>
> x x x x
>
> (B) Income, war-profits, and excess-profits taxes imposed by the authority of any foreign country; *but this deduction shall be allowed in the case of a taxpayer who does not signify in his return his desire to have to any extent the benefits of paragraph (3) of this subsection (relating to credit for taxes of foreign countries)*;" (emphasis supplied.)

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In the Lednicky cases, C.T.A. Cases Nos. 570 and 646, promulgated December 29, 1960 and March 2, 1961, involving the same issue, we held:

> "A perusal of the above-quoted codal provision yields the unmistakable conclusion that a taxpayer, who does not indicate in his return a desire to have the benefits of credit for taxes of foreign countries, shall be entitled to a deduction claim for income, war-profits, and excess-profits taxes imposed by authority of a foreign country and paid or accrued within the taxable year. In the case at bar, it is admitted that the petitioners paid U.S. Federal income taxes in 1955 and did not indicate in their 1955 re-amended tax return that they desired to enjoy the benefits of credit for the income taxes they paid to the United States government. Clearly, they are entitled to deduct from their gross income for the year 1955 the amount of ₱471,867.32 paid as U.S. Federal income taxes."

Respondent contends that petitioners cannot claim a deduction for U. S. Federal income tax inasmuch as they have not shown that they are entitled to claim a tax credit for the same. This contention has already been disposed of adversely to petitioners in the Lednicky cases, supra.

It is further argued by respondent that the underlying reason for crediting or allowing as deduction foreign income taxes paid is to relieve the taxpayer of the heavy burden of double taxation. Accordingly, since petitioners have already been allowed a deduction by the U.S. Government of Philippine income tax paid by them, they have already avoided the burdensome effect of double taxation. Hence, they have no more reason for claiming as a deduction from gross income in the Philippines the U.S. income taxes which they paid. This argument loses sight of the fact

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that double taxation is not avoided by allowing deduction of foreign income taxes, although the Philippine income tax is similarly allowed as deduction by a foreign country. The fact remains that the same income (in this case, the income from Philippine sources) is taxed twice, both by the Philippine Government and by the U.S. Government. The reciprocal deduction and credit provisions of both income tax laws serve merely to lighten the burden of double taxation.

It may also be stated that neither the Philippine Income Tax Law nor the U.S. Income Tax Law requires as a condition for deductibility of foreign income taxes that the local income tax be not claimed as a deduction in the return filed in the foreign country. What is prohibited is the allowance of the claim for deduction and at the same time a tax credit for foreign income taxes. The law requires the taxpayer to choose either one.

With respect to the interest paid by petitioners in the amount of $1,113.52 for late payment of their 1956 U. S. income tax liability, the same is deductible as interest on indebtedness under Section 30 (b)(1) of the Revenue Code (Commissioner vs. Vda. de Prieto, G.R. No. L-13912, Sept. 30, 1960; Palanca vs. Commissioner of Internal Revenue, C.T.A. Case No. 571, Dec. 2, 1959; Lednicky vs. Collector of Internal Revenue, supra; Magaz vs. Collector of Internal Revenue, C.T.A. Cases Nos. 354 & 355, May 11, 1961). In regard, however, to the amount of $774.89 representing 6% of the underestimated 1956 U.S. income tax, the same cannot be allowed as a deduction inasmuch as it is a penalty rather than an interest.

> "The 6% per annum charge is a penalty addition to the tax and cannot be claimed or used as a deductible expense. Report of Senate Finance Committee (1954 Code, p. 593)" (1956 PH Sec. 3931)

And as a charge for penalty is not deductible from gross income (see Anderson vs. Posadas, 66 Phil. 205), the claim for deduction in the amount of $774.89 should be disallowed.

Petitioners ask that they be awarded interest at the legal rate on the amount refundable to them. It not appearing that the collection of the tax in question was arbitrary or manifestly unwarranted, the Government is not liable to pay interest. (See Gibbs v. Collector, G.R. Nos. L-14166 & L-14320, April 28, 1962.)

IN VIEW OF THE FOREGOING CONSIDERATIONS, respondent is hereby ordered to refund to petitioners V. E. Lednicky and Maria Valero Lednicky the amount of ₱89,802.51 computed as follows:

Amount of income subject to tax . . . (declared in original return)		₱519,548.41
Less: (DEDUCTIONS CLAIMED IN AMENDED RETURN)		
1956 U.S. income tax paid September 5, 1957 . .	$ 46,824.20	
1957 Estimated U.S. income paid Sept. 5, 1957. .	45,912.10	
Interest for late payment of 1956 U.S. income tax	1,113.52	
	$ 93,849.82	

Converted to Philippine Currency at ₱2.015 to $1.00	₱189,107.39	
Stamps, bank commissions, etc.	67.01	189,174.40
Amount subject to tax		₱330,374.01
Tax due thereon		₱126,152.04
Amount paid		215,954.55
Amount refundable		₱ 89,802.51

Without pronouncement as to costs.

SO ORDERED.

Manila, May 10, 1963.

R M Umali
ROMAN M. UMALI
Associate Judge

I concur:

AUGUSTO M. LUCIANO
Associate Judge