REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

MARCELO STEEL CORPORATION,
Petitioner,

- versus - C.T.A. CASE NO. 172

THE COLLECTOR OF INTERNAL REVENUE,
Respondent.

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April 1, 1957

D E C I S I O N

The petitioner is a corporation duly organized and existing under and by virtue of the laws of the Philippines, with offices at Malabon, Rizal. It is engaged in three (3) industrial activities, namely, (1) manufacture of wire fence, (2) manufacture of nails, and (3) manufacture of steel bars, rods and other allied steel products. During theyears 1952 and 1953, the last two mentioned industrial operations, more specifically, the manufacture of nails and the manufacture of steel bars, rods and other allied steel products, enjoyed the benefits of tax exemption under Republic Act No. 35.

On May 21, 1953, the petitioner filed an income tax return for the year 1952, reflecting a net income of ₱34,386.58 realized solely from its business of manufacturing wire fence, an activity which is not tax exempt, and on March 31, 1953, it filed its income tax return for the year 1953, showing a net income of ₱58,329.11 realized from the same source, i.e., the manufacture of wire fence.

On the basis of the said income tax returns filed by the petitioner for the years 1952 and 1953 which did not reflect the financial results of its tax exempt business activities, the respondent assessed the total sum of ₱12,750.00.

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Accordingly, the petitioner paid the said amount assessed against it on the following dates:

Tax Year	Date	Amount
1952	May 30, 1953	₱ 3,458.50
1952	August 15, 1953	3,458.50
1953	May 15, 1954	5,833.00
		₱12,750.00

On October 1, 1954, the petitioner filed amended income tax returns for taxable years 1952 and 1953, showing that it suffered a net loss of ₱871,407.37 in 1952, and ₱104,956.29 in 1953. The said losses were arrived at by consolidating the gross income and expenses and/or deduction of the petitioner in all its business activities, as follows:

For the year 1952

Net income, taxable industry:		
Wire Fence		₱34,386.58
Net loss, tax exempt industries:		
Nails	(₱ 60,950.20)	
Steel bars. . . .	(102,335.20)	(163,285.40)
Total net loss		(₱104,956.29)

On October 1, 1954, the petitioner, claiming that instead of earning the net income shown in its original income tax returns for 1952 and 1953, it sustained the losses shown in its amended income tax returns for the same years, filed its request for refund of the income taxes for the said years amounting to ₱12,750.00 which it allegedly erroneously paid to the respondent.

After more than ten months of waiting without any action being taken by the respondent on the claim for refund, and in order to protect its right under Section 306 of the National Internal Revenue Code, the petitioner, on August 13, 1955, filed with this Court the instant petition for review.

There are two issues to be resolved in this case, namely, (1) whether or not the petitioner may be allowed to deduct from the profits realized from its taxable business activities, the losses sustained by its tax exempt industries, and (2) whether or not the action for refund, with regard to the sum of ₱3,458.50 which was paid on May 30, 1953, has already prescribed under Section 306 of the Tax Code.

On the first issue. In the United States, it is an established principle in income taxation that tax exempt income is separate and distinct from taxable income. And following this principle, the United States Internal Revenue Code contains a specific provision forbidding the deduction of -

> "Any amount otherwise allowable as a deduction which is allocable to one or more classes of income other than interest (whether or not any amount of income of that class or classes is received or accrued) wholly exempt from the taxes imposed by this chapter." (I.R.C., Sec. 24 (a) (5); Mertens, Law of Federal Income Taxation, Vol. 4, p. 530)

The reason for segregating tax exempt income from taxable income is aptly stated in the regulations issued to implement Section 24(a) (5) as follows:

> "The object of section 24(a) (5) is to segregate the exempt income from the taxable income, in order that a

> double exemption may not be obtained through the reduction of taxable income by expenses and other items incurred in the production of items of income wholly exempt from tax. Accordingly, just as exempt items of income are excluded from the computation of gross income under section 22, so section 24(a) (5) excludes from the computation of deductions under section 23 all items referable to the production of exempt income, other than exempt interest." (Mertens, Law of Federal Income Taxation, Vol. 4, p. 531)

Considering that our income tax law is patterned after that of the United States, it can also be correctly stated in this jurisdiction that exempt income is distinct and separate from taxable income, and therefore, expenses incurrred in earning tax-exempt income is not deductible from taxable income. Certainly, it is incumbent upon taxpayers "to segregate expenses connected with their business from which taxable income was derived from expenses incident to the earning of claimed nontaxable income." (Victor G. Marquissee et al., 11 BTA 334) Hence, in the case at bar, the petitioner cannot deduct from the profits realized from its taxable industries, the losses sustained by its tax exempt business activities, and therefore, the claim for refund was properly denied by the respondent.

Moreover, when the petitioner applied for, and was granted tax exemption under Republic Act No. 35, he also agreed to the segregation of tax exempt income from taxable income and assumed the obligation of (1) filing a separate income tax return, and (2) keeping separately the accounting records relative to the industry declared tax exempt. (Sec. 7, Executive Order No. 433, dated April 13, 1951; see also Sec. 7, Rep. Act. No. 901) The petitioner herein cannot now complain of the action of the respondent Collector of Internal Revenue in considering as separate and distinct from each other the tax exempt income and tha taxable income.

In view of our ruling on the first issues, we deem it not necessary to decide the second question for a resolution of the same will be purely academic.

(WHEREFORE, finding no error in the decision of the Collector of Internal Revenue denying the claim for refund of the petitioner, the sameis hereby affirmed with costs against the petitioner.

SO ORDERED.

Cebu City for Manila, April 1 , 1957

(SG.D) MARIANO NABLE
Presiding Judge

I CONCUR:

(SGD.) AUGUSTO M. LUCIANO
Associate Judge

I vote to dismiss the appeal for lack of jurisdiction. The Collector of Internal Revenue has not yet decided the claim for refund, hence there is no decision to appeal to this Court.

Manila, April 26, 1957.

(SGD.) ROMAN M. UMALI
Associate Judge