Lit -

BULLETIN PUBLISHING CO.,
Petitioner,

- versus - **C.T.A. CASE NO. 346**

December 26, 1958
Ordered [illegible]

THE COLLECTOR OF INTERNAL REVENUE,
Respondent.

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D E C I S I O N

This is a petition to review the decision of the Collector of Internal Revenue on the disputed assessment of deficiency income taxes for the years 1949, 1951 and 1952 arising from the disallowance of alleged excessive bonus deductions claimed by the petitioner in its income tax returns for said years. The petition also seeks the refund of the sum of ₱21,018.00 which petitioner paid on said deficiency assessment after the institution of this appeal.

Petitioner is a duly organized corporation engaging in the business of publishing the newspaper "Manila Daily Bulletin". In its income tax returns for the years 1949, 1951 and 1952, petitioner claimed, among others, deductions for the following amounts paid as salaries and bonuses during those years to its four principal officers and executives:

	Annual Salaries	Bonuses Paid 1949	1951	1952
C. Taylor	₱40,000.00	₱ 60,000.00	₱ 70,000.00	₱ 70,000.00
H. F. Wilkins	20,000.00	30,000.00	30,000.00	30,000.00
H. A. Linn	20,000.00	30,000.00	30,000.00	30,000.00
E. Abundo	17,000.00	24,000.00	24,000.00	24,000.00
T o t a l ---	₱97,000.00	₱144,000.00	₱154,000.00	₱154,000.00

(Pars. 1 & 2, Petition for Review, and Supplemental Petition for Review; Par. 1, Answer, and Answer to the Supplemental Petition for Review.)

Upon investigation, respondent disallowed the deduction of the excess of such bonuses over the annual salary of each of these officers and assessed petitioner deficiency income taxes for 1949, 1951 and 1952 in the total amount of ₱37,560.00.

Upon petitioner's request for reconsideration, respondent modified his prior determinations by allowing the deduction of the bonuses in question to the extent that such bonuses did not exceed 125% of the respective annual salaries of said officers. Accordingly, the deficiency income taxes due from the petitioner, Bulletin Publishing Co., were recomputed as follows:

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Net income per return	₱171,095.57
Add: Unreasonable compensation ..	22,750.00
Net income per reinvestigation ..	₱193,845.57
Tax due thereon	₱ 23,261.47
Less: Amount already paid	20,531.47
DEFICIENCY INCOME TAX DUE	₱ 2,730.00

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Net income per return	₱128,243.78
Add: Unreasonable compensation ..	32,750.00
Net income per reinvestigation ..	₱160,993.78
Tax due thereon	₱ 37,078.00
Less: Amount already paid	27,960.00
DEFICIENCY INCOME TAX DUE	₱ 9,118.00

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Net income as per investigation (return)	₱142,093.22
Add: Unreasonable compensation ..	32,750.00
Net income per reinvestigation ..	₱174,843.22
Tax due thereon	₱ 40,956.00
Less: Amount already paid	31,786.00
DEFICIENCY INCOME TAX DUE	₱ 9,170.00

(Exhs. R & 14, pp. 70-75, BIR rec.; pars. 3, 4, 5 & 6, Petition for Review, and Supplemental Petition for Review; par. 1 Answer, and Answer to the Supplemental Petition for Review.)

A request for the reconsideration of the aforesaid assessment was denied by respondent in his letter dated January 15, 1957 and received by the petitioner on January 23, 1957. From the aforesaid decision, petitioner filed this instant petition for review. After the instant appeal was instituted, petitioner paid the sum of ₱21,018.00 representing the principal of the aforesaid deficiency income taxes, exclusive of surcharge and interest. (Par. 9, Supplemental Petition for Review.) Petitioner now seeks the refund of said amount.

The only question at issue in this appeal is whether or not the total bonuses paid to the officers of petitioner-corporation during the period under review are deductible from gross income, within the purview of Section 30 (a) (1) of the Tax Code.

Under the Income Tax Law, petitioner, in computing its net income, is allowed as deductions:

> "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; x x x" (Section 30 (a) (1), Tax Code.)

Section 72 of the Income Tax Regulations of the Department of Finance, which implements the aforequoted codal provision, reads as follows:

> "Sec. 72. Bonuses to employees.- Bonuses to employees will constitute allowable deductions from gross income when such payments are made in good faith and as additional compensation for the services actually rendered by the employees, provided such payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services

rendered. It is immaterial whether such bonuses are paid in cash or in kind or partly in cash and partly in kind. Donations made to employees and others, which do not have in them the element of compensation or are in excess of reasonable compensation for services, are not deductible from gross income."

From the foregoing law and regulations, the question of the deductibility depends upon whether or not the bonuses are reasonable in amount. While there is no fixed and fixable yardstick for determining what is reasonable and what is not, each case will have to turn on its own facts. Our law on this particular matter was merely lifted from cognate provisions of the United States Federal Income Tax Law and of the interpretative administrative regulations. (Madrigal & Paterno vs. Rafferty & Concepcion, 38 Phil. 414; Perez Rubio vs. Collector, 54 Phil. 256.) Consequently, reliance has to be placed upon the standards or tests that have been developed, recognized and applied by American Courts, in applying the same law for the purpose of determining the reasonableness of a particular salary or compensation. These tests have been summarized by a well known authority on Income Taxation, as follows:

"x x x. There are various tests which have been commonly applied in determining the reasonableness of the particular salary or compensation, such as the ratio of the particular salary and the aggregate salaries to gross income, the size of the particular business, the extent and scope of the employees' work, the employees' qualifications and contributions to the business venture, amount of salaries paid to the particular employee in prior years, general economic conditions, prevailing salaries paid to employees performing similar services in a comparable enterprise, the availability of others to fill the office held by the particular employee, and salary policy of the corporation as to all employees." (Mertens, Law of Federal Income Taxation, Vol. 4, Sec. 25.51, p. 412, quoted in Kuenzle and Streiff, Inc. v. The Collector of Internal Revenue, C.T.A. Case No. 169, July 18, 1956.)

We shall therefore proceed to examine the relative facts in this case to determine whether the bonuses here involved comport with the statutory qualifications and the implementing regulations.

In justifying the deductibility of the bonuses in question in their entirety, petitioner points to the services rendered by and the responsibilities of the four officers who were granted bonuses. These responsibilities and duties, as gathered from the record of the case, are as follows:

"Mr. Carson Taylor is the president and director of the Bulletin Publishing Co. and the publisher of the Manila Daily Bulletin, the daily newspaper published by the said company. As such, he has been responsible for the formulation and execution of the company's policies. In the performance of said services, he has had to work more than 8 hours daily." (Exh. Y, pp. 158-169, BIR rec.; Petitioner's Memorandum, p. 2; Exh. U-4, p. 93, BIR rec.)

"Mr. M. A. Linn is the vice-president and director of the Bulletin Publishing Co. and the business and advertising manager of the Manila Daily Bulletin. Being the vice-president, he assists Mr. Taylor in the formulation and execution of the company's policies. As business and advertising manager, he supervises a staff of about 10 people; attends to the newspaper advertisers, plans out and issues special supplements for various business firms; obtains new advertising clients for the newspaper, supervises preparation of advertisements and supervises advertising agencies affiliated with the newspaper. He works 8 hours a day and oftentimes has to work up to seven o'clock in the evening. Because of the nature of his work, he has to attend social and business gatherings after office hours." (Exh. Y, pp. 168-170, BIR rec.; Petitioner's Memorandum, p. 4.)

"Mr. H. Ford Wilkins is the managing editor of the Manila Daily Bulletin. As such, he is responsible for the editorial policies of the newspaper, administrative management of the editorial staff and supervision of all the newspaper's reporters and columnists. He writes editorials and selects the various features that go into the paper. He has a staff of from 30 to 35 people. There is no other editor except a news editor whom he supervises. He keeps office hours in the morning and early evening on an average of 9 hours a day. (Exh. Y, pp. 171, 182-183, BIR rec.; t.s.n. pp. 88-89; Petitioner's Memorandum, p. 3.)

"Mr. Emilio Abundo is the secretary, accountant and treasurer of the Company and is also in-charge of the personnel and circulation department. He performs the duties of a secretary and treasurer of a corporation and attends to the needs and complaints of the employees, numbering about 300. As accountant, he exercises control and supervision over the accounting records and books of the corporation. Aside from these, he promotes the circulation of the Manila Daily Bulletin. In view of his varied responsibilities, he generally works beyond regular business hours and on Sundays." (T.S.N. pp. 7, 12-16; Petitioner's Memorandum, p. 5.)

It is also argued on behalf of petitioner that the officers' full time devotion to petitioner's business; and their primary responsibilities for its growth and continued financial success, thereby consistently making profits prior to, during and subsequent to the tax years in question equally justify the deductibility of the bonuses in question. Upon the other hand, respondent contends that the excess bonuses are neither compensation for actual services rendered nor ordinary and necessary nor reasonable.

There is no doubt that actual personal services were rendered by the four officers and that they were competent in their line of work. The credibility of the testimonies of petitioner's witnesses, H. F. Wilkins, M. A. Linn, and E. Abundo, as to the extent of the services rendered by them and the time spent in the performance of their duties has not been seriously questioned. However, we believe that their testimonies are not sufficient to establish the reasonableness of the bonuses paid. In every case, there must be not only evidence of the extent and quality of the work done but also of the value of the services (Mertens, Law of Federal Income Taxation, Vol. IV, Sec. 25.54, p. 415), which is one of the most important factors in determining reasonableness.

We find that petitioner failed to introduce evidence showing the value of the services rendered such as by introducing evidence of compensation paid to employees performing comparable services in companies engaged in the same type of work. (Builders Steel Co. vs. Commissioner of Internal Revenue, 197 F 2d, 263.) There is also an absence of evidence showing what it would cost petitioner to fill in the positions held by the four officers in question and the salary policy of the corporation to all employees as the guide post to determine the value of the services rendered. On the other hand, respondent presented documentary exhibits showing a comparative analysis of the bonuses paid to corresponding officers, incomes and surpluses of petitioner-corporation and the Manila Times Publishing Co., also a news-publishing corporation, which data relate to the tax years 1949, 1951 and 1952. (Exhs. 16, 19, 20 and 21.) We find that there is a great disparity between the salary scales of the same set of officers in the two corporations. Even if it were to be conceded that the officers of petitioner corporation assumed comparatively more duties and responsibilities, still the substantial difference between the salaries paid to the comparable officers in the two corporations is not fully justified, there being no showing as to the great disparity of the services rendered between two comparable persons.

It will also be noted that the percentage of net taxable income to gross income of the Manila Times Publishing Co., Inc. for these years ranges from about 16% to 20%, while that of the Bulletin Publishing Co. is from 6% to 9%. This indicates that petitioner incurred proportionately more operating expenses during the years in question than the similar and larger concern. Although this may not directly prove the value and quality of the services rendered by the officers of petitioner, nevertheless, it tends to prove that its management could not have been as efficient as contended by petitioner. This circumstance militates against petitioner's contention that the bonuses in question are reasonable compensation.

We have likewise to take into account that there was no established policy or criterion in the fixing of the bonuses of the said officers of petitioner. On the contrary, there is evidence to show that the bonuses of the three other officers were practically fixed by Mr. Taylor who owned the controlling majority of stock and who was solely responsible, in effect, for the determination of corporate policies. And the bonus which Mr. Taylor authorized for himself was actually fixed by himself to equalize his compensation with those of the other three officers. It should also be considered that the said four officers of petitioner who were granted the bonuses in question owned 91% of petitioner's capital stock. And more important is the fact that Mr. Taylor, the president, who owned a large majority of the capital stock (76%) was the one who fixed the bonuses and only at the end of the year. Thus, the action of the other officers was but to acquiesce to or informally approve the said determinations of bonuses by the former.

Another factor to be taken into account in the determination of reasonableness of compensation is the ratio of the bonuses paid to the net income. In the case at bar, the proportions of the total bonuses paid the four officers to the net taxable income for the years 1949, 1951 and 1952, are 84%, 120% and 108%, respectively. This goes to show that the net taxable income of petitioner would have been doubled if the said bonuses were not paid. Indeed, this alone might not be conclusive. However, if we take into consideration the other circumstances previously observed, specially the fact that the bonuses in question were ascertained at the end of the corresponding tax years, the enormity of this proportion lends weight to respondent's conclusion that these bonuses were actually distributed profits. "That the alleged salaries were never paid or ascertained until the earnings of the corporation became fixed at the end of the year may indicate that they are in fact a distribution of profits." (Mertens, Law of Federal Income Taxation, Vol. IV, Sec. 25.46, pp. 400-401).

The instant case is very similar to that of Blue Bell Inc. vs. U.S., 1950, 93 F Supp. 614, where a portion of the bonuses plaintiff paid to its six officers throughout the fiscal year were held unreasonable and therefore not deductible as an ordinary and necessary expense on the ground that although the corporation had greatly increased its profits over a period of five years, the record showed that the profits had been paid out mainly as bonuses to the management (six officers) which comprised the majority stockholders and the dividends to all stockholders or to stockholders in general had not increased proportionately over the same period of time.

In the Blue Bell Inc. case the officers did a fine management job and increased the volume of plaintiff's sales by 13 per cent, the dollar volume by 66-2/3 per cent and the net profits of the business over 1,600 per cent. The officers' salaries were increased and the bonuses were paid in the year in question and the preceding year which were not pursuant to contract, the same having been based on the sole determination of its president. However, dividends declared during this period increased hardly at all.

In ruling that the bonuses paid by the taxpayer corporation were unreasonable, the U.S. Court of Claims held:

"Had the minority stockholders been able to deal at arm's length with the management, we cannot imagine their having agreed that all increases in profits should go to management and none at all to the minority stockholders. This seems to us a fair test to use in determining whether or not these bonuses were reasonable.

"It is true that the distribution to all the stockholders of the amount paid on bonuses would have increased their dividends very little, but, at the same time, it is difficult to avoid the conclusion that those in control of the corporation saw the profits there and distributed them, or some part of them, to themselves, as additional compensation for their services, instead of making a general distribution. By so doing they reaped the benefit of the profits at the expense of the minority stockholders, and they secured for tax purposes a deduction of these amounts from corporate income." (Blue Bell, Inc. v. U.S., *supra*, at 616; underscoring supplied.)

Petitioner seeks to destroy the veracity of the facts in Exhibit 18-A as presented by respondent by pointing out contradictions between Exhibit 18-A and Exhibits Nos. 19, 20 and 21. It is further alleged that the comparative evidence submitted by the respondent lacks material details. We find, however, that although such contradictions exist, still the data as to the comparative gross incomes, net incomes and surpluses remain unassailed. Furthermore, we believe that it is not for the respondent to show the unreasonableness of the salaries in question, rather the burden is for petitioner to prove the same to be reasonable.

In view of petitioner's failure to show the reasonableness of the deduction for bonuses beyond that already allowed, we are constrained to hold that the deficiency assessment resulting from the disallowance of the bonuses to the extent that it is unreasonable should not be disturbed and correspondingly, the payment made thereon proper.

WHEREFORE, the decision appealed from is hereby affirmed, and the petition for the refund of the sum of ₱21,018.00 paid as deficiency income taxes for the tax years 1949, 1951 and 1952 should be, as it is hereby, denied. The petitioner is hereby ordered to pay to the respondent the sums of ₱1,050.90 as 5% surcharge and ₱3,257.79 as 1% monthly interest pursuant to Section 51(e) of the Tax Code. With costs against petitioner.

SO ORDERED.

Manila, December 26, 1958.

AUGUSTO M. LUCIANO
Associate Judge

WE CONCUR:

Not appealed.

MARIANO NABLE
Presiding Judge

ROMAN M. UMALI
Associate Judge