Library

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

PHOENIX ASSURANCE CO., LTD.,
Petitioner,

- versus - C.T.A. CASE NO. 305

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

x - - - - - - - - - - - - - - - x

PHOENIX ASSURANCE CO., LTD.,
Petitioner,

- versus - C.T.A. CASE NO. 543

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

x - - - - - - - - - - - - - - - x

February 19, 1962

D E C I S I O N

By these two separate appeals, which by reason of their community of factual and legal issues on the question of withholding tax had been consolidated and jointly heard, petitioner seeks the review of respondent's assessments for deficiency income tax for the years 1950, 1952 and 1954 and withholding tax for 1952, 1953 and 1954, and the refund of alleged overpaid income tax for 1953.

Petitioner, a foreign insurance corporation organized and existing under the laws of Great Britain, is licensed to do business in the Philippines. It duly filed its income tax returns for the years 1950, 1952, 1953 and 1954 on the bases of which it paid income tax. In particular, it paid ₱42,869.00 as income tax for 1953.

In the 1950 return, petitioner deducted a premium reserve on marine insurances computed on the basis of 40% of the total premiums received on marine policies during the year. In the returns for 1952, 1953 and 1954, it claimed as an expense deduction for head office expenses allocable to its Philippine or local operations amounting to 5% of the gross premium income from Philippine sources. Furthermore, it included in the gross premium income premiums received on insurances directly underwritten by its Philippine agents, as well as those ceded by Philippine insurance companies to its London office in pursuance of reinsurance treaties executed abroad. However, it did not deduct therefrom portions of premiums received on insurances directly underwritten in the Philippines which its London office ceded to non-resident foreign insurers pursuant to reinsurance treaties executed abroad. But, it excluded from its gross premium income for 1954 that portion of insurance ceded by domestic insurance companies to its London office pursuant to insurance treaties executed abroad, and also deducted that portion of insurance directly underwritten in the Philippines and ceded by its London office to non-resident foreign reinsurers pursuant to reinsurance treaties likewise executed without the Philippines.

Conformably to respondent's rulings, dated February 8 and July 20, 1955, to the effect that a resident foreign insurance company which, under a reinsurance contract executed abroad, cedes part of the insurance premiums received by it for risks located in the Philippines to a non-resident foreign insurance company is not subject to withholding tax (later revoked by rulings of March 20 & June 26, 1957), petitioner filed amended returns for the years 1952 and 1953. Taxwise, in view of these rulings, it neither withheld income tax on the reinsurance cessions nor filed returns therefor.

And on the theories that petitioner's deduction claim for head office expenses allocable to its Philippine operation should be only 5% of the net premium income derived from Philippine sources; that the premium reserve on marine insurances should be computed on the basis of 100% of the total premiums received during the last three months; and that portion of the insurances directly underwritten in the Philippines by petitioner which was ceded by petitioner's London office to non-resident foreign insurance companies pursuant to insurance treaties executed abroad is subject to withholding tax, respondent Commissioner assessed against petitioner deficiency income taxes for the years 1950, 1952 and 1954 in the respective sums of ₱1,884.00, ₱5,667.00 and ₱2,847.00, and withholding taxes for 1952, 1953 and 1954, including fraud and compromise penalties, in the amounts of ₱113,949.63, ₱88,689.52 and ₱73,318.48, respectively. These assessments are now before us for review.

As respects the year 1953, respondent withdrew the deficiency income tax assessment for ₱19,730.00. In lieu of a deficiency assessment for 1953, respondent's examiner recommended the refund of ₱20,180.00 as overpaid income tax for the year, which overpayment is admitted by respondent in his answer to the amended and supplemental petition for review.

The following are the issues involved in this cases:

1. With respect to the income tax assessment for the year 1950, whether or not petitioner's computation of the premium reserve for marine insurance is correct and in accordance with law;

2. Whether or not the right of respondent to issue the deficiency income tax assessment for 1952 against petitioner has prescribed;

3. With respect to the income tax assessments for 1952, 1953 and 1954, whether or not petitioner's claim for deduction representing head office expenses is correct;

4. With respect to the withholding tax assessments for the years 1952, 1953 and 1954, whether or not that portion of insurances directly underwritten in the Philippines by petitioner which was ceded by way of reinsurances by petitioner's head office in London to non-resident foreign reinsurers pursuant to treaties of reinsurances executed abroad, is subject to withholding tax; and

5. Whether or not the imposition of 50% surcharge on the withholding tax assessments is legal and proper.

For the year 1950, petitioner computed its marine insurance reserve at ₱37,147.04 which is equivalent to 40% of the total marine insurance premiums received during the year. It argues that the reserve, as fixed, is even less than that required by Section 186 of the Insurance Law, which provides:

> "Section 186. To determine the liability upon the contracts of insurance of any foreign or domestic insurance company, other than life, the Insurance Commissioner shall require such companies to charge as the liability for reinsurance of its outstanding policies, in addition to the capital stock and all outstanding claims, a sum equal to fifty per cent of the gross premiums received on policies or risks having not more than a year to run, and pro rata on all gross premiums received having more than a year to run; Provided, <u>That for marine risks the insuring company shall be required to charge as the liability for reinsurance fifty per centum of the premiums written in the policies upon yearly risks, and the full premiums written in the policies upon all other marine risks not terminated</u>." (Underscoring supplied.)

Believing that the marine insurance reserve thus fixed is excessive, respondent reduced the same to ₱25,374.47 which represents the total marine insurance premiums underwritten during the last three months of the year. This reduction is predicated on respondent's premious ruling of August 31, 1953 that "in case of marine insurance, the full amount of the premiums received for the last ninety days of the year on overseas shipments x x x may be taken as the reserve, it being assumed that ninety x x x days are approximately the length of time required before shipments reach their destinations or before claims are received by the insurance companies."

The proviso of the afore-quoted statute speaks of two kinds of marine risks: yearly risks and all other risks not terminated. For the coverage of the former risks, the law requires an insurance company to set up a reserve of 50% of the premiums written in the policies and 100% of said premiums in cases involving the latter risks. The rationale of this reserve requirement is to provide a fund with which to mature or liquidate either by payment or reinsurance with other companies, future unaccrued and contingent claims, and claims accrued, but contingent and indefinite as to amount or time of payment (Maryland Casualty Co. vs. U.S., 251 U.S. 342, 64 L. ed 297).

The amount of ₱25,374.47 to which respondent has leveled off the marine reserve set up by petitioner defeats the above-stated purpose of the law. This amount, as already stated, corresponds only to the total marine insurance premiums underwritten during the last three months of the year. Obviously, it falls short of the amount required by the proviso of Section 186 of the Insurance Law for either the yearly risks or other risks not terminated.

Although, we are not in a position to declare that the 40% reserve set up by petitioner complies in full with the proviso of Section 186 of the Insurance Law, for the reason of absence of evidentiary basis, yet, we believe that under the circumstances the same is not excessive.

Consequently, we believe and so hold that the deficiency income tax assessment for the year 1950 in the amount of P1,884.00 cannot be sustained.

We come now to the question whether or not the right of respondent to assess deficiency income tax for the year 1952 has prescribed.

Petitioner filed his income tax return for the year 1952 on April 1, 1953, reporting a net loss of P199,583.93. Subsequently, on August 30, 1955, it amended the return by excluding from the gross income, portions of marine insurances ceded by petitioner's London Office pursuant to reinsurance treaties, thereby resulting in a tax in the sum of P2,502.00. On September 5, 1955, respondent determined against petitioner an income tax liability of P2,502.00 which determination was superseded by the assessment, dated July 24, 1958, for P5,667.00.

Brushing aside petitioner's defense of prescription, respondent contends that the five-year period within which to assess the tax should not be counted from the date of filing of the original return on the ground that the same is incomplete, but from the date of filing of the amended return.

We find no merit in respondent's contention that the original return for 1952 is incomplete. The mere fact that the return indicates a loss of ₱199,583.93 does not render it incomplete. An examination of Exh. LL (also Exh. 30-A), which is the original income tax return for 1952, discloses that said return contains information on the various items of income and deduction from which respondent may intelligently compute and determine the tax liability of petitioner (see Peerless Iron Pipe Exchange, Inc. vs. Commissioner of Internal Revenue, 23 BTA 900, 904). Hence, the prescriptive period of five years should be counted from April 1, 1953, the date the original return for 1952 was filed. And upon the finding that the revised assessment was made on July 24, 1958 or more than five years from the filing of the tax return for 1952, we rule that the right of respondent to assess the income tax for 1952 has already prescribed.

The amended income tax return for 1952 which was filed by petitioner on August 30, 1955 did not toll the running of the prescriptive period of five years, for the filing of an amended return does not operate to extend the statute (Burford Oil Co. vs. Commissioner, 153 F 2d 745; Peerless Iron Pipe Exchange, Inc., 23 BTA 900; Vitamin Co., 21 BTA 311; Mabel Elevator Co., 2 BTA 517;

National Refining Co. of Ohio, 1 BTA 236; Hotel de Soto Co., TC Memo. Op., Dkt. 3215 (1945?).

As regards the deduction claim of a portion of petitioner's head office expenses amounting to 5% of the gross premium underwritten in the Philippines, respondent believes that the same is unreasonable and excessive. In determining said allocable portion, he used the same rate as that availed of by petitioner, that is, 5%, but used as a basis the net premiums received by the latter during the year involved.

Actually, the "net premium income" consists of the total premiums received in the Philippines minus premiums ceded to non-resident foreign insurance companies pursuant to treaties of reinsurance executed abroad. The ceded premiums became income of the non-resident foreign reinsurers. It is inequitable to take into consideration the gross premiums, of which the ceded premiums are part, in computing petitioner's head office expenses allocable to its Philippine or local operation. Hence, we sustain respondent's computation relative to this deduction.

The issue of whether or not that portion of the insurances directly underwritten in the Philippines by the petitioner which was ceded by way of reinsurances by petitioner's London office to non-resident foreign reinsurers pursuant to reinsurance treaties executed without the Philippines is subject to withholding tax has been affirmatively resolved in Alexander Howden & Co., Ltd., et al. vs. Commissioner of Internal Revenue, Manila Civil Case No. 22848, November 24, 1961, and British Traders' Insurance Co., Ltd. vs. Commissioner of Internal Revenue, C.T.A. Case No. 683, January 30, 1962.

Disposing adversely the contention that the ceded portion is not an income derived from sources within the Philippines, we held:

> "This last claim of the plaintiffs does not consider the true and real nature of the reinsurance premiums in question. In the instant case, it is admitted that the plaintiffs received from the Commonwealth Insurance Co., a domestic corporation, the reinsurance premiums on risks originally insured with the said local company. (Par. 3, STIPACTS.) In other words, the reinsurance premiums were taken from the premiums earned by the Commonwealth Insurance Co. from its insurance business conducted in the Philippines, and then ceded to the plaintiffs herein. Hence the reinsurance premiums were derived from the Philippines. The word 'source' can convey only one idea, that of origin, and the origin of the said reinsurance premiums was the Philippines. (Manila Gas Corp. vs. Collector of Internal Revenue, 62 Phil. 895.)
>
> "There can be no question that from the insurance business directly underwritten in the Philippines by the Commonwealth Insurance Co., all the premiums, including those ceded or transferred to the plaintiffs herein, were earned from sources within the Philippines. Undoubtedly, if the Commonwealth Insurance Co. did not cede or transfer to the plaintiffs, by way of reinsurance part of its earned premiums, the said ceded premiums would have been subjected to the payment of income tax and the Commonwealth Insurance Co. would have been required to pay the same. In short, the reinsurance premiums represent the

share of the plaintiffs in the premiums earned from Philippine sources, and the plaintiffs should be required to pay the corresponding Philippine income tax on the same.

"Furthermore, the activity that actually produced the ceded premiums was the underwriting of risks or insurances in the Philippines, and this particular activity enjoyed the protection of the government. Therefore, it is but fair and right that the said reinsurance premiums be levied upon to defray part of the expenses of the Philippine Government. (Mertens, Law of Federal Income Taxation, Vol. 8, Chap. 45, Sec. 45.27, pp. 63-64.)" (Alexander Howden & Co., Ltd. et al. vs. Commissioner of Internal Revenue, _supra_.)

Holding that reinsurance premiums ceded to non-resident foreign insurers are fixed and determinable, we said:

"We also find this contention of the plaintiffs to be untenable. Note that Section 53 (b) of the Tax Code which is quoted above specifically mentions 'premiums' as among those subject to withholding income tax. _Ubi Lex Non Distinguit, Nec Nos Distinguere Debemus_. When the law does not distinguish, there is no justification to make any distinction. Applying this well settled principle to the present case, we believe and so hold that this term 'premiums as used in said Section 53 (b) includes reinsurance premiums. (See Mertens, Law of Federal Income Taxation, Vol. 8, Chap. 44, Sec. 44.48, p. 170 quoted _supra_.) Therefore, the reinsurance premiums which were paid to the plaintiffs are subject to withholding income tax.

"Granting, _arguendo_ that the word 'premiums' does not include reinsurance premiums, it is our opinion that the said reinsurance premiums, although not fixed annual income, may be classified as determinable periodical income." (Alexander Howden & Co., Ltd. et al. vs. Commissioner of Internal Revenue, _supra_.)

Finding no valid and strong reasons to reverse our stand in the Howden and British Traders' cases, we affirm that that portion of insurances directly underwritten in the Philippines by petitioner which was ceded by way of reinsurances by petitioner's head office in London to non-resident foreign reinsurers pursuant to treaties of reinsurances executed abroad is subject to the payment of income tax prescribed in Section 54 of the Tax Code.

We shall now discuss whether or not the imposition of 50% surcharge for failure to file withholding tax return is proper.

It appears that petitioner did not file withholding tax returns for the years 1952, 1953 and 1954 in view of the two rulings of the Bureau of Internal Revenue dated February 8 and July 20, 1955, respectively, which, as afore-said, absolves from withholding tax liability reinsurance premiums ceded to non-resident foreign insurers pursuant to reinsurance treaties executed abroad. We are convinced that, under the circumstance, petitioner's failure to file withholding tax returns is due to an honest belief that the insurance cessions at bar are not subject to withholding tax, and, therefore, there was no obligation on its part to file returns therefor. Having acted upon a reasonable cause, petitioner should not be held liable for the 50% surcharge imposed in Section 72 of the Tax Code (Collector of Internal Revenue vs. Batangas Transportation Co., G. R. No. L-9692, January 6, 1958).

We notice that, in addition to the basic withholding tax and fraud penalty, respondent has also imposed compromise penalty in the sum of ₱100.00 for each year. It has been repeatedly held that the Commissioner of Internal Revenue cannot arbitrarily impose and collect compromise penalties (Collector of Internal Revenue vs. Bautista, G. R. Nos. L-12250 & L-12259, May 27, 1959; Collector of Internal Revenue vs. University of Santo Tomas, G. R. Nos. L-11274 & L-11280, November 28, 1958).

We will now resolve petitioner's claim for refund of ₱23,409.00. In this connection, it may be stated that on the basis of the original income tax return for 1953, petitioner paid in equal installments income tax amounting to ₱42,869.00. Subsequently, petitioner filed an amended return, in consequence of which respondent determined a deficiency of ₱19,730.00 based on the disallowance of adjustment relative to petitioner's 1952 premium reserve. Finally, upon reinvestigation of petitioner's tax liability for 1953, the disallowance of premium reserves was reconsidered and the deficiency assessment was withdrawn. However, believing that the portion of petitioner's head office expenses allocable to Philippine or local operation should be equal to only 5% of the net premiums received by the petitioner during the year, respondent's examiner found that the tax due for 1953 is ₱22,689.00, and recommended that ₱20,180.00 be returned to petitioner as overpaid income tax for that year. As already stated, this overpayment is admitted by respondent in his answer to the amended and supplemental petition for review.

In view of our opinion favorable to respondent's contention that the portion of petitioner's head office expenses allocable to Philippine or local operation should be equated to 5% of the net premiums received by petitioner during the year, we hold that petitioner is entitled to the refund of ₱20,180.00 as overpaid income tax for 1953.

WHEREFORE, petitioner Phoenix Assurance Company, Ltd., is hereby ordered to pay the Commissioner of Internal Revenue the respective amounts of ₱75,966.42, ₱59,059.68 and ₱48,812.32, as withholding tax for the years 1952, 1953 and 1954, and ₱2,847.00 as income tax for 1954, or the total sum of ₱186,685.42 within thirty (30) days from the date this decision becomes final. Upon the other hand, the respondent Commissioner is ordered to refund to petitioner the sum of ₱20,180.00 as overpaid income tax for 1953, which sum is to be deducted from the total sum of ₱186,685.42 due as taxes.

If any amount of the tax is not paid within the time prescribed above, there shall be collected a surcharge of 5% of the tax unpaid, plus interest at the rate of 1% a month from the date of delinquency to the date of payment, provided that the maximum amount that may be collected as interest shall not exceed the amount corresponding to a period of three (3) years. Without pronouncement as to costs.

SO ORDERED.

Manila, February 14, 1962.

MARIANO NABLE
Presiding Judge

I concur:

AUGUSTO M. LUCIANO
Associate Judge

I reserve my vote.

ROMAN M. UMALI
Associate Judge