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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

LI SENG GIAP TRADING
CORPORATION,
Petitioner,

- versus - C.T.A. CASE No. 1810

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

Jan. 28/72

D E C I S I O N

Petitioner appealed from the decision of respondent, dated September 8, 1966, holding it liable for 1963 deficiency income tax amounting to ₱22,717.15, inclusive of interest, surcharge, and compromise penalty.

Petitioner is a corporation engaged in the business of importing and selling diesel engines. On April 14, 1964, petitioner filed its 1963 corporate income tax return claiming therein certain deductions from gross income such as salary, repair, travel, and miscellaneous expenses.

The books of accounts and other accounting records of petitioner for 1963 were examined and investigated by Supervising Revenue Examiners Luis Blaza and Benjamin Madrasto for income and business tax purposes. Thereafter, they recommended to respondent the issuance of a deficiency income tax assessment against petitioner due to the disallowance of salaries and other deductions, to wit:

SALARIES OF THE FOLLOWING

Anthony Lee - Pres. & Gen. Mgr. --	₱5,000.00
Henry Lee - Treasurer ------------	1,250.00
Charles Lee - Secretary ----------	1,250.00
D. Madlangsakay - Accountant ---	5,000.00
F. Laureano - Asst. Cashier -----	5,000.00
L. M. Guzman - Legal Counsel ----	5,000.00
Magiliw Torres - Personal Secretary of the President ------	5,000.00
Jose Dee Huat - Cashier ----------	5,000.00
Elvira Serrano - Bookkeeper -----	3,000.00
Gloria Marzan - Gen. Clerk ------	3,000.00
Antonio Acaso - Messenger -------	3,000.00
Gil Belgica - Filing Clerk ------	3,000.00
Arturo Cruz - Accounting Clerk --	3,000.00
Jesus Armada - Supervising Clerk -	5,000.00
Silvino Roy - Clerk --------------	3,000.00
Felicitas Rivera - Clerk ---------	3,000.00
Purchase of an air conditioner charged to miscellaneous expenses ----------------------	955.00
Travel and representation (Travel Insurance of Mr. Anthony P. Lee, Personal) -----	400.00
C-1 #3886 - representing surcharge for residence certificate ------	11.70
TOTAL DISALLOWANCE ----------	₱59,366.70

The records show that in 1963 petitioner made a gross sales of ₱788,457.45 and a gross income of ₱226,409.42. It paid salaries amounting to ₱67,677.90. Respondent's examiners, however, disallowed ₱58,000.00 thereof and allowed only ₱9,677.90 as a salary deduction from gross income.

On August 31, 1965, respondent assessed against and demanded from petitioner the payment of deficiency income tax amounting to ₱19,279.32, inclusive of interest. The said assessment was protested by petitioner in its letter dated September 24, 1965. It was denied in respondent's letter of September 8, 1966. Respondent, therefore, demanded payment of the deficiency income tax in the amount of ₱22,717.15, inclusive of 5% surcharge, 1% monthly interest from September 1, 1965 to September 30, 1966, and compromise penalty of ₱50.00 for late payment, computed as follows:

1963 deficiency income tax per letter of demand dated August 31, 1965 ----------	₱19,279.32
Add: 5% surcharge on basic tax (₱17,810.00) ---------	890.50
1% monthly interest on deficiency tax from 9-1-65 to 9-30-66 -----------	2,497.33
Compromise for late payment ----------------	50.00
TOTAL AMOUNT DUE ON SEPTEMBER 30, 1966 ---------------	₱22,717.15

Petitioner appealed to this Court from the decision of respondent. The issues presented to us for resolution are the following:

(1) Whether or not the salaries of ₱58,000.00 paid by petitioner in 1963 are deductible from its gross income;

(2) Whether or not the sum of ₱955.00 deducted by petitioner from its gross income - for repair of an air conditioning unit is an allowable deduction;

(3) Whether or not the sum of ₱400.00 representing travel insurance premium of Mr. Anthony P. Lee, President of petitioner, is an allowable deduction from gross income; and

(4) Whether or not the surcharge of ₱11.70 paid (C-1 Tax) for late payment is deductible from gross income.

FIRST ISSUE:

Petitioner contends that the salaries in question were paid for services actually rendered and they were reasonable in amount while respondent claims that said salaries were not paid for services actually rendered because (1) there were no contracts of employment between the employees and petitioner; (2) no income tax was withheld from their salaries; (3) no Social Security System deductions were made from the salaries of the officers and employees of petitioner; and (4) the payment of salaries to petitioner's officers and employees was resorted to as a scheme to lessen petitioner's income tax obligation.

Before salary deductions from gross income may be allowed, it is incumbent upon petitioner to show (1) that personal services were actually rendered by its employees; (2) the compensation paid by it were reasonable, ordinary and necessary; (3) the salary expense was paid within the taxable year; and (4) the salary expense was incurred in carrying on a trade or business. Section 30, (a)(1) of the Revenue Code, provides:

> SEC. 30. Deductions from gross income. - In computing net income there shall be allowed as deductions -
>
> (a) Expenses:
> (1) In general:- 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; traveling expenses

> while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for the purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

Petitioner's defense that the salaries in question were paid for services actually rendered by its officers and employees is borne by the evidence, both testimonial and documentary. With the exception of Mr. Anthony P. Lee, President and General Manager, who worked from 8:00 to 12:00 A.M., the rest of the officers and employees worked from 8:00 to 12:00 A.M., and from 2:00 to 5:00 P.M., or eight hours daily. (Pp. 11-32, t.s.n., pp. 68-69, t.s.n.) They are permanent employees who rendered services to the petitioner for the whole year (pp. 66 and 78, t.s.n.); they were not paid monthly compensation, but they were paid annually in lump sum before the closing of the year (pp. 34-35 and 78, t.s.n.) through payroll and/or voucher payment. (Exhs. B, B-1 to B-15, pp. 46-61, CTA rec.) These officers and employees were also rendering services to petitioner's sister corporations for which they received additional compensation as evidenced and reflected in their 1963 income tax returns, to wit: Delfin Madlangsakay, Felicidad Laureano, Elvira Serrano, Gloria Narzan, and Leonardo Guzman. (Pp. 40-42, 45-47, 48-49, 52-54, 55, 57, 58-59, t.s.n.; Exhs. C to C-2, D to D-2, E to E-2, F to F-3, G to G-3, pp. 62, 63-64, 65, 67-68, & 69, CTA rec., respectively.)

The 1963 individual income tax returns of the other employees were not presented in evidence because they are no longer working with petitioner. The testimony of petitioner's accountant, Mr. Delfin Hadlangsakay, supported by salary vouchers and/or payrolls, salary checks, and income tax returns are sufficient justification to sustain the defense of petitioner because of the preponderance of evidence in its favor. In a case where an accountant testified as to the deductibility of the expenses but his testimony was not contradicted by the Government, it was held that the expenses in question may be allowed as a deduction from gross income. (Basilan Estates vs. Comm., G.R. No. L-22492, September 5, 1967.)

The report of respondent's examiners that petitioner neither (1) withheld the income taxes due from its officers and employees' salaries nor (2) deducted from their salaries contributions to the Social Security System are persuasive instances in the resolution of the question at issue but they do not negate the finding of this Court that the officers and employees listed above have actually rendered personal services to petitioner in 1963 and received compensation therefor.

Respondent contends that certain employees of petitioner received bigger compensation that those occupying responsible positions. As examples, respondent cited the case of Antonio Acaso, a messenger, whose salary of ₱3,000.00 exceeded the salaries of Messrs. Henry Lee and Charles Lee, Treasurer and Secretary, respectively, who received only ₱1,250.00 each per annum. In the case of Atty. Leonardo Guzman, Legal Counsel, respondent claims that he received a salary of ₱5,000.00 per annum which is equivalent only to the salary of Mr. Jesus Armada, a supervising clerk. Because of the disparity in in the amounts of compensation received by the officers and employees of petitioner, the payment thereof which is made only once at the end of the year, and the absence of employer-employee relationship between petitioner and its employees, the investigating revenue examiners concluded that the said salary expense of ₱58,000.00 for 1963 was merely a device to lessen petitioner's income tax liability.

The findings and views of the supervising revenue examiners are hollow and misleading. Section 30(a)(1) of the Revenue Code, supra, does not require or impose the condition adopted by the said revenue examiners. as a condition precedent to the deductibility of petitioner's salary expense from its gross income. It is enough that the legal requirements for deductibility are satisfied, namely: (1) the expense must be both ordinary and necessary; (2) the expense must be paid or incurred within the taxable year; and (3) the expense must be incurred in carrying on a trade or business.

All the said requirements of deductibility are present in this case, except the alleged glaring disparity in the amount of compensation received by petitioner's officers and employees. But the examiners' bases for the disallowance of the salary expense are only apparent but not solid and real.

On the basis of the evidence, there is no question that the salary expense was incurred or paid by petitioner in 1963 in carrying on a trade or business. Even a casual employee without a formal contract of employment is entitled to a reasonable amount of compensation provided that services were rendered by him to the petitioner. It is immaterial for purposes of deduction from gross income whether the salary was paid weekly, monthly, or yearly, as long as payment was made within the taxable year - the salary expense is still ordinary. In interpreting the meaning of the word "ordinary", the U. S. Supreme Court said:

> "x x x. Now, what is ordinary, though there must always be a strain of constancy within it, is nonetheless a variable affected by time and place and circumstance. Ordinary in this context does not mean that the payments must be habitual or normal in the sense that the same taxpayer will have to make them often. x x." (Welch v. Helvering, 290 U.S. 111, 113.)

The disparity in the amount of compensation is brought about by factors which the revenue examiners have overlooked. Aside from the petitioner, its office premises at 242-246 Casal St., San Miguel, Manila, were also occupied by its sister companies in 1963, namely: Li Seng & Sons, Inc., Li Seng Giap & Co., Inc., Thomas J. Lee, Inc., and the Universal Motors Corporation. These family corporations engaged the services not only of their respective employees but also those of the sister corporations. The said employees, therefore, received compensation depending upon the nature, volume, extent and scope of their services to a corporation or corporations as shown by their individual income tax returns for 1963. (Exhs. C, D, E, F, and G.) (In the circumstances, it cannot be said that the salaries of petitioner's employees in 1963 are not necessary and ordinary because the amounts thereof were passed upon and determined by the Board of Directors. After all, the settled rule is that a corporation has the right to fix the compensation of its employees (Ledesma v. Collector of Internal Revenue, 42 Phil. 912), and courts are not inclined to interfere with a proper exercise of that right. (Levine & Bros., Inc. v. Comm., 101 F (2d) 391; Wagegro Corp. 38 B.T.A. 1225.) Accordingly, we hold that the salary expense of ₱58,000.00 is deductible from petitioner's gross income of ₱266,409.42.

SECOND ISSUE:

Respondent's examiners disallowed the deduction of ₱955.00 as a business expense because the same was used in the purchase of an air-conditioner as evidenced by Voucher No. 50, dated April 14, 1963. Petitioner, however, claimed that the air-conditioner was repaired and the damaged parts were replaced to arrest it's deterioration and appreciably prolong its life.

Section 68 of the Income Tax Regulations allows the deduction of the cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an efficient operating condition. The receipt, however, evidencing the incidental repair was not submitted to the Court for its scrutiny and evaluation and, therefore, the deduction of ₱955.00 as a business expense is hereby disallowed.

THIRD ISSUE:

Respondent's examiners disallowed the deduction of ₱400.00 as a business expense on the premium paid on the travel insurance taken by the petitioner's President in his business trip to Germany because the same was considered a personal expense.

We sustain respondent on this point because petitioner failed to show that the said premium constitutes additional compensation to the insured. Moreover, any amounts paid for premiums on any life insurance policy covering the life of an officer or employee or any person financially interested in the business of the taxpayer when the taxpayer is directly or indirectly a beneficiary under such policy are not deductible. (Sec. 121, Income Tax Regulations.)

FOURTH ISSUE:

Taxes paid or accrued within the taxable year, except those listed in the Revenue Code, are deductible from gross income. The word "taxes", however, means taxes proper and no deduction should be allowed for amounts representing interest, surcharge or penalties incident to delinquency. (Sec. 80, Income Tax Regulations.) Consequently, the sum of ₱11.70, representing the surcharge for late payment of the corporate residence tax, is not deductible from gross income.

COMPROMISE PENALTY

Payment of compromise penalty in extrajudicial settlement of a penal liability for violation of any provision of the National Internal Revenue Code can not be enforced by the Commissioner of Internal Revenue against a taxpayer in a civil action like the case at bar. He could only suggest to the taxpayer the payment of the compromise penalty or institute a criminal action independent of the civil suit; otherwise, the court cannot enforce the collection of the compromise penalty without the consent of the taxpayer - a doctrine repeatedly enunciated in our jurisprudence.

After deciding the controversial issues, there is due and collectible from petitioner the sum of ₱433.82, computed as follows:

Net income per return ----------		₱118,052.84
Add: Unallowable deduction:		
Miscellaneous expense ----------	₱955.00	
Insurance premium -	400.00	
Surcharge (C-1-Tax)	11.70	1,366.70
Net income per investigation ---		₱119,419.54
Corporate income tax due thereon -------------------		₱ 27,826.00
Less amount already assessed ---		27,416.00
Balance of tax due -----------		₱ 410.00
Add: ½% monthly interest from 4-16-64 to 8-31-65 -------		33.82
TOTAL AMOUNT DUE -------------		₱ 442.82

WHEREFORE, the decision of respondent Commissioner of Internal Revenue appealed from is modified. Petitioner is hereby ordered to pay respondent or his duly authorized representative its 1963 deficiency income tax of ₱442.82, inclusive of deficiency interest, plus the surcharge of 5% and interest at the rate of one per cent (1%) a month, subject to the limitations prescribed in Section 51(e) of the Tax Code, as amended. Without pronouncement as to costs.

SO ORDERED.

Quezon City, March 28, 1972.

Estanislao R. Alvarez
ESTANISLAO R. ALVAREZ
Associate Judge

WE CONCUR:

R M Umali
ROMAN M. UMALI
Presiding Judge

Ramon L Avanceña
RAMON L. AVANCEÑA
Associate Judge