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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

December 29, 1960

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

- versus -

C.T.A. CASE NO. 570

COLLECTOR OF INTERNAL REVENUE,
Respondent.

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

D E C I S I O N

This is an action filed by the petitioners for the refund of the sum of ₱150,269.00, plus six (6%) per cent interest, which is part of the ₱283,194.10 allegedly illegally and erroneously collected by respondent as second installment of the former's income tax for the year 1955.

The petitioners are husband and wife, American citizens, and residents of the Philippines (Par. 1, Petition; Par. 1, Answer, pp. 1 & 21, CTA rec.), deriving all their income from Philippine sources.

On February 28, 1956, petitioners filed their 1955 income tax return, reporting a gross income of ₱1,771,124.63 and a net income of ₱1,052,550.67 (Par. 3, Petition; Par. 1, Answer; Exhs. "Z" & "1", pp. 14 & 2, BIR rec.).

On April 19, 1956, petitioners filed an amended income tax return, reporting the same gross income of ₱1,771,124.63, but a lesser net income in the amount of ₱1,012,554.51. (Exhs. "N" & "2", pp. 19 & 7, BIR rec.)

On the basis of the amended return, petitioners paid income taxes amounting to ₱570,252.00, itemized as follows:

(a) Withholding Tax Exhs. "N" & "2"; see BIR Form W-2, p. 3, BIR rec.)	₱ 5,863.80
(b) Official Receipt No. 678795 dated May 12, 1956 (Exh. "C", t.s.n. pp. 123-124)	282,194.10
(c) Official Receipt No. 743105 dated August 13, 1956, Exh. "O-1", t.s.n. pp. 123-124)	282,194.10
Total	₱570,252.00

After audit of petitioners' income tax return for 1955, respondent determined a deficiency income tax of ₱16,116.00 (Annex "A", Petition; Par. 5, Petition & Par. 1, Answer; Exhs. "P" & "4", p. 41, BIR rec.), which was paid on December 5, 1956.

Meanwhile, in 1955, the petitioners filed with the United States Internal Revenue Agent in Manila their U.S. Federal income tax returns for the years 1947, 1951, 1952, 1953 and 1954 (U.S. Treasury Department, Internal Revenue, Service Forms Nos. 1040, and 1116, marked Exhs. "T", "T-1", "T-2", "T-3", & "T-4", Folder of Petitioners' Exhibits, pp. 40-58; t.sn., pp. 246-251; 284-285). These returns were filed on a cash basis of income realized from Philippine services (t.s.n., pp. 269-271, 274-275, 277-282, 293-294 & 300). In accordance with these returns, petitioners paid in 1955 U.S. Federal income taxes, including penalties, and delinquency interest, to the U.S. Director of Internal Revenue, Baltimore, Maryland, thru the National City Bank of New York, Manila Branch, which payment is itemized as follows:

Item	U.S. $ Paid	Phil. ₱ Paid
U.S. Tax (Income)	$235,933.66	₱471,867.32
Penalties	8,488.20	16,976.40
Interest accrued up to May 15, 1955	20,166.96	40,333.92
Totals	$264,588.82	₱529,177.64

(Exhs. "U", "U-1", "U-2", "U-3", "U-4", "U-5", pp. 59-65, Folder of Petitioners' Exhibits; see also Exhs. "C", "D", "E", "E-1", "F", "G", "H", "H-1", "I", "J", "K", pp. 16-26, Folder of Petitioners' Exhibits.)

In remitting the payment to the U.S. Director of Internal Revenue, the petitioners incurred exchange and bank charges totalling ₱4,143.91.

Their attention having been called to their failure to claim as deduction from gross income derived within the Philippines the U.S. Federal taxes thereby paid, the petitioners, on August 11, 1958, amended their Philippine tax return for 1955, claiming the following deduction:

(1) U.S. Federal income taxes	₱471,867.32
(2) Interest accrued up to May 15, 1955	40,333.92
(3) Exchange and bank charges	4,143.91
Total	₱516,345.15

(Exhs. "A", "A-1" & "B", p. 52 BIR rec.)

and, on the same date, filed with the respondent Collector, a claim for refund of the sum of ₱166,384.00 (Exh. "B", pp. 61-65, BIR rec.), which later was reduced to ₱150,269.00, computed as follows:

New income as per Respondent's investigation (Exh. P, BIR rec. p. 41)		₱1,039,412.96
Add:		
Capital Gain per Reamended Income Tax Return, Schedule D (Exh. A (original)	₱332,007.97	
Less - Capital Gain per Amended Income Tax Return, Schedule D (Exh. N)	106,371.97	
Additional Long Term Capital Gain		225,636.00
Total adjusted Net Income per Respondent's investigation		₱1,265,048.96
Less additional deductions claimed in [Exh. A (original)]		
(1) Deficiency interest paid U.S. Internal Revenue Service -		
Reported in Reamended Return	₱ 40,333.92	
Reported in Amended Return	40,261.66	
Increase in Deficiency interest paid U.S. Internal Revenue Service ...	₱ 72.26	
(2) Exchange & Banking charges paid	4,143.91	
(3) U.S. Income taxes paid	471,867.32	
Total additional deductions claimed in Reamended Income Tax Return		₱ 476,083.49

Adjusted Net Income pursuant Re-amended Income Tax Return and Deficiency Assessment adjustments (Exhs. A (original) & P)	₱788,965.47
Less personal exemption	3,000.00
Amount subject to tax	₱785,965.47
Amount of Tax	₱436,099.00
Tax Paid (Pars. 6 & 7, supra)	586,368.00
Amount refundable	₱150,269.00

Finally, on August 12, 1958, the petitioners filed the present petition for review.

The respondent raised several issues in his answer to the petition for review. However, except that involving the question of deductibility or non-deductibility of the U.S. Federal taxes and interests thereon, he has not pressed them in his memorandum. Consequently, we shall limit ourselves to the question whether or not income taxes paid by the petitioners to the U. S. Government and interests thereon for the years 1947, 1951, 1952, 1953 and 1954 are deductible for the purpose of determining their taxable net income for 1955.

Section 30 (c) (1) (B) of the National Internal Revenue Code provides:

> "SEC. 30. Deductions 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;"

A perusal of the above-quoted codal provision yields the unmistakable conclusion that a taxpayer, who does not indicate in his tax 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.

But the respondent contends that to merit tax deduction under Section 30 (c) (1) (B) of the Tax Code, the petitioners must show that they are entitled to claim the benefits of tax credit and that the United States allows a similar credit to citizens of the Philippines residing in the former country, pursuant to Section 30 (c) (3) (B), (c) (4) (A) & (B), and (c) (6) & (7) of the same Code. Accordingly, since the petitioners' income in question is derived solely from Philippine sources and the petitioners failed to establish tax credit reciprocity on the part of the United States, their deduction claim must be denied.

The above contention is not well-taken. Section 30 (c) (1) (B) of the Tax Code is plain and unambiguous. It does not provide that a taxpayer should be entitled to the benefits of tax credit in order to be allowed a tax deduction. To sustain the contrary proposition would read into the law something which Congress did not intend to include therein. And, even on the assumption arguendo that the petitioners are not entitled to any credit for the taxes paid to the United States government, still, they should be allowed a deduction therefor. As the U.S. Tax Court held:

> "We think, however, that, since petitioners are not entitled to any credit for taxes either paid or accrued to Canada under section 131, supra, they should be allowed as deductions from gross income for the calendar years 1940 and 1941, under section 23 (c) (1) (C) of the Code, as amended, the amounts paid to the Canadian Government on the partnership income." (Max Freudmann v. Commissioner of Internal Revenue; Henri Freudmann v. Commissioner of Internal Revenue, 10 T. C. 775.)

To the same vein is the ruling of the U.S. Treasury Department, which we reproduce as follows:

> "It is the opinion of this office that where an alien resident of the United States pays foreign income taxes and claims a credit for such taxes, but the credit is disallowed for the reason that he is a citizen or subject of a foreign country which does not grant a similar credit to citizens of the United States, the foreign taxes should be allowed as deduction. As indicated above, the purpose of the statute apparently was not

> to penalize a taxpayer by disallowing both a credit for foreign income taxes and a deduction for such taxes. It was intended that such taxes should either be allowed as a credit against the United States income tax, subject to the limitations contained in Section 131 of the Revenue Act of 1932, or allowed as deduction from gross income under section 23 (c) of that Act." (See Ft. n. 607, Vol. 5, Mertens, Law of Federal Income Taxation, Sec. 33.02, citing GCM 19727, CB 1938-1, p. 255.)

The respondent then contends "that in the case at bar involving a claim for tax deduction of income taxes for 1947, 1951, 1952, 1953 and 1954, all paid in 1955, against petitioners' gross income reported in their Philippine income tax return for 1955, said back taxes can no longer be deducted." Taxwise, this contention is without merit. Taxes are deductible only in the year of payment by taxpayers on a cash basis, and only in the year of accrual by taxpayers on an accrual basis (Mertens, Law of Federal Income Taxation, Vol. 5, Sec. 27.52, p. 64). It appearing that the petitioners report their incomes and disbursements on a cash basis, and that they paid the U.S. Federal income taxes in question in the year 1955, it follows that said taxes are deductible in 1955 (Estate of B. W. Cadwallader, 13 T.C. 214).

As regards the question involving the amount of ₱40,333.92 paid as interest on account of tax delinquency, it is now settled that interest payment for delinquent taxes is deductible under Section 30 (b) (1) of the Tax Code as interest on indebtedness (Commissioner v. Vda. de Prieto, G.R. No. L-13912, Sept. 30, 1960).

Petitioners pray for the payment of interest at the legal rate (6%) on the amount of ₱150,269.00 from August 11, 1958, the date the petitioners filed their demand for refund with the respondent. The claim is premised on the provisions of Articles 27, 32 (c), 1169 and 2209 of the New Civil Code.

The evidence does not disclose that respondent, who is a public servant, refused or neglected, without just cause, to perform his official function. The petitioners' claim for refund was filed with the respondent on August 11, 1958. The following day, August 12, 1958, without waiting for respondent's decision, they filed the petition for review. Neither is there any showing that respondent directly or indirectly defeated, violated, impeded or impaired petitioner's right against deprivation of property without due process of law. The mere fact that respondent subsequently did not act favorably on the claim for refund does not mean that petitioners' right to the refund of overpaid income taxes was violated without due process. Following the doctrine laid down by the Supreme Court in Collector vs. St. Paul's Hospital of Iloilo, G. R. No. L-12127, May 25, 1959; Collector vs. J. M. Sweeney, et al., G. R. No. L-12178, August 21, 1959, we are constrained to hold that the petitioners are not entitled to payment of interest on the amount refundable to them.

IN VIEW OF THE FOREGOING CONSIDERATIONS, the Commissioner of Internal Revenue is hereby ordered to refund to petitioners V. E. Lednicky and Maria Valero Lednicky the amount of ₱150,269.00, without special pronouncement as to costs.

SO ORDERED.

Manila, December 29, 1960.

MARIANO NABLE
Presiding Judge

WE CONCUR:

AUGUSTO M. LUCIANO
Associate Judge

ROMAN M. UMALI
Associate Judge