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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

November 29, 1966

COMPANIA GENERAL DE
TABACOS DE FILIPINAS,
Petitioner,

versus C. T. A. CASE NO. 290

THE COLLECTOR OF
INTERNAL REVENUE,
Respondent.

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# D E C I S I O N

This is an appeal from the decision of the respondent Collector (now Commissioner) of Internal Revenue dated October 31, 1955 holding the petitioner, Compañia General de Tabacos de Filipinas, liable for the sums of ₱65,594.96 and ₱849.21, representing deficiency income tax for 1939 and 1940, respectively.

There is no dispute as to the facts of the case.

Compañia General de Tabacos de Filipinas, hereinafter referred to as Tabacalera, is a foreign corporation authorized to engage in business in the Philippines. Its main office in this country is in the City of Manila.

Tabacalera filed its income tax returns for the years 1939 and 1940 on April 22, 1940 and April 19, 1941, respectively. In both income tax returns, Tabacalera classified its income into (1) income from sources "within" the Philippines and (2) income from sources "without" the Philippines. As a foreign corporation, petitioner paid the amounts of ₱95,903.31 and ₱86,283.39 for the years 1939 and 1940, respectively, as income tax on its income derived solely from sources within the Philippines, pursuant to Section 24, in relation to Section 37, of the National Internal Revenue Code.

On March 14, 1946, respondent assessed against Tabacalera the amounts of ₱90,664.45 and ₱51,457.27, representing alleged deficiency income tax for 1939 and 1940, respectively. After several communications were exchanged between the parties, these amounts were reduced on October 18, 1948 to ₱65,594.96 for 1939 and ₱36,047.37 for 1940. Contending, however, that the said amounts were not legally due, petitioner, on March 26, 1951, protested the assessments. On October 31, 1955, respondent wrote petitioner affirming the income tax assessment for 1939 in the sum of ₱65,594.96 but reducing the income tax assessment for 1940 to ₱849.21. To enforce collection thereof, a warrant of distraint and levy was issued by respondent on January 26, 1956. On May 19, 1956, respondent ordered the sale at public auction of petitioner's two parcels of land and their improvements on July 15, 1956.

On June 25, 1956, Tabacalera filed the present petition for review contesting the aforesaid assessments and seeking to enjoin respondent from collecting the tax through the summary remedies of distraint and levy. On July 14, 1956, this Court issued a preliminary writ of injunction restraining respondent from taking further action on or giving effect to the aforesaid order of seizure and sale. This order was affirmed by the Supreme Court on July 30, 1960 in Case G. R. No. L-11151.

The deficiency income tax in question was arrived at by respondent as follows:

1939

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|---|---|
| Net income per return . . . . . . . | ₱1,197,541.39 |
| Add: Unreported profit from sale in the U.S. of sugar, tobacco, etc. purchased in the Philippines . . . . . . . . . . . . | 723,448.35 |
| Propaganda expenses . . . | 96,488.61 |
| Net taxable income. . . . . . . . | ₱2,017,478.35 |
| 8% tax thereon. . . . . . . . . . | ₱ 161,398.27 |
| Less: Amount already paid. . . . | 95,803.31 |
| Balance still due . . . . . . . . | ₱ 65,594.96 |

1940

| | |
|---|---|
| Net income from all sources according to taxpayer's "Income Tax 1940 - Resumen". . | ₱1,002,725.74 |
| Add: Understated profits from the sale of floating equipment (material flotante) . . . . . . . . . | 500.00 |
| Propaganda expenses . . . . . . . | 85,931.86 |
| Net taxable income . . . . . . . | ₱1,089,157.60 |
| 8% tax due thereon . . . . . . . | 87,132.60 |
| Less: Amount already paid . . . | 86,283.39 |
| Balance still due . . . . . . . . | ₱ 849.21 |

(Exh. 59, Memorandum Report dated August 27, 1962, pp. 50-52 BIR record; see also p. 2, Memorandum of Respondent.)

As correctly stated by respondent, aside from the defense of prescription raised by petitioner, only three items are the subject of controversy by the parties, to wit: (1) the unreported profit from sales in the United States of sugar, tobacco, etc., purchased in the Philippines; (2) the propaganda expenses; and (3) the understated profits from the sale of floating equipment.

With respect to the propaganda expenses, the memorandum of the Chief, Litigation Division of the Bureau of Internal Revenue dated August 27, 1962, as approved by the Acting Commissioner of Internal Revenue (Exh. 59), conceded that the amounts of ₱96,488.61 and ₱85,931.86 are really advertising and promotional expenses of petitioner for 1939 and 1940, respectively, and being ordinary and necessary business expenses, they are legally deductible under Section 30(a)(1) of the Revenue Code. The same is true with regard to the so-called under-declared profits of ₱500.00 which could not be traced in or reconciled with the record of the case.

With the consequent allowance and approval of the deduction of the amounts of ₱96,488.61 and ₱85,-931.86, respondent concedes that there is no deficiency income tax due from petitioner for 1940. Consequently, the only item in dispute is the "unreported profit from the sale in the United States of sugar, tobacco, etc., purchased in the Philippines" in the amount of ₱723,448.35 for the year 1939.

In the light of the decisions of the Supreme Court in the cases of La Compañia General de Tabacos de Filipinas v. The Collector of Internal Revenue, 51 Phil. 154, affirmed by the United States Supreme Court in 279 U. S. 306, and Compañia General de Tabacos de Filipinas v. The Collector of Internal Revenue, 68 Phil. 239, involving the same parties and similar set of facts as the instant case, respondent insists that the so-called "Unreported profit from the sale in the United States of sugar, tobacco, etc. purchased in the Philippines" (Exh. E-1, p. 26, BIR record I) constitutes income derived by petitioner from sources "within" the Philippines and is subject to Philippine income tax. In both cases, it was held that the profits derived by Tabacalera constituted income taxable in the Philippines because -

> . . ."Appellee's (petitioner's) contention if sustained would give a preference to a foreign corporation doing business through a branch office in the Philippine Islands over a domestic corporation engaged in the same line of business to the amount of the three per cent tax upon the income in question. That was not the purpose and intent of the Legislature. It is very apparent that the Legislature intended that a foreign corporation with a branch office in the Philippine Islands could do business here upon the same terms and conditions as a domestic corporation, and that it never intended that a foreign corporation with a branch office and doing business in the Philippines should

> have any preference over a domestic corporation engaged in the same line of business." (68 Phil. 251-252.)

If the instant case were to be resolved in the light of the decisions in the above-mentioned cases and in accordance with the provisions of the previous Income Tax Law, the view of respondent would seem to be correct. It is to be noted, however, that these decisions were rendered before the effectivity of the National Internal Revenue Code on July 1, 1939, which provides that the income tax provided therein shall apply to income earned from January 1, 1939. In both cases, the income tax involved was assessed for the years 1922, 1928, 1929 and 1930, pursuant to section 10(a) of Act No. 2833, as amended by section 7 of Act No. 2926 of March 20, 1920, which provided as follows:

> "There shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company, partnership, joint-account (cuenta en participación), association, or insurance company, organized in the Philippine Islands, no matter how created or organized, but not including duly registered general co-partnerships (compañías colectivas), a tax of three per centum upon such income; and a like tax shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources within the Philippine Islands by every corporation, joint-stock company, partnership, joint-account (cuenta en participación), association, or insurance company, organized, authorized, or existing under the laws of any foreign country, including interest on bonds, notes, or other interest-bearing

> obligations of residents, corporate or otherwise, and including the income derived from dividends or net profits subject to the tax established in this subsection." (68 Phil. 248.)

It is to be observed that the section above quoted had two separate and distinct provisions: one provides for a tax of 3% for each calendar year on the annual total net income derived from all sources by domestic corporations, and the other for a like tax "upon the total net income received in the preceding calendar year from all sources within the Philippine Islands" by any corporation organized and "existing under the laws of any foreign country." On the basis of these provisions of the former Income Tax Law, the Supreme Court held that it was the purpose and intent of the Legislature that a foreign corporation which had a branch office in the Philippines and was engaged in business here should pay the same amount of income tax on that business as a domestic corporation; otherwise, a foreign corporation with a branch office in the Philippines and doing business here would have an advantage over a domestic corporation engaged in the same line of business (51 Phil. 159-160). This must be so because the law then in force did not define, much less distinguish between, income from sources within the Philippines and income from foreign sources.

Under the National Internal Revenue Code, foreign corporations are given a different treatment. Section

24 of the said Code imposes upon foreign corporations engaged in business in the Philippines the same rates of tax as domestic corporations with respect to income from sources within the Philippines. Section 37 defines what is income from sources within and income from sources without the Philippines. The latter section defines the situs of income derived from the purchase of personal property in one country and its sale in another as follows:

> ". . . Gains, profits, and income derived from the purchase of personal property within and its sale without the Philippines or from the purchase of personal property without and its sale within the Philippines shall be treated as derived entirely from sources within the country in which sold."

Implementing and interpreting the law, Section 159 of Revenue Regulations No. 2 states that -

> "Income derived from the purchase and sale of personal property shall be treated as derived entirely from the country in which sold. The word 'sold' includes 'exchanged.' The 'country in which sold' ordinarily means the place where the property is marketed. . . ."

A casual reading of the provisions of the present law, unlike the former law, will readily show that there is now a dividing line between income derived from sources "within" and income from sources "without" the Philippines. Since respondent admits that this unreported profit of P723,448.35 was from the sale in the United States of sugar, tobacco, etc., purchased in the Philippines (Exhibits B, B-1 and B-3, pp. 25-

26, CTA rec.), there seems to be no question that under the present law and the regulations promulgated thereunder, the profit derived from such sale by petitioner, a foreign corporation, is income derived from sources within the United States and not taxable here. To hold otherwise would be to disregard the specific provision of the law.

While admitting that the "sugar, tobacco, etc., were sold in the United States," respondent takes, however, the position that "the contracts for the said sales were perfected in the Philippines" (Exh. E-3). No evidence was presented by respondent regarding this matter, but the evidence of petitioner on record shows that the articles in question were consigned to petitioner's agents in the United States, J. B. Havre & Co., E. F. Pipe and Hazard & Co., for them to sell; that the shipment of the merchandise was covered by insurance, with petitioner as the beneficiary; that the agents in the United States were the ones which decided such matters as when to sell, the volume to be sold and at what price to sell, endeavoring to obtain the best price in the market; that no confirmation from petitioner was required before the sale could be effected; and that the transaction was entered as a sale in the books of petitioner only upon receipt of notice from the agents as to the quantity sold and the selling price, as well as the expenses of sale (pp. 9-13, t.s.n.; see also Exhs. K & L, pp. 44-45, 46, BIR rec. II). Since the meeting of the minds of the buyer and the seller (represented by its agents in the United States) upon the thing which was the object of the contract (sugar, tobacco, etc.) and the price took place in the United States, under Article 1450 of the old Civil Code or Article 1475 of the new Civil Code, the sale was perfected in the United States.

Even granting, arguendo, that the contracts of sale were perfected in the Philippines, the fact that the sales were consummated in the United States, which is not disputed, argues strongly against the pretension of respondent. The situs of a sales transaction is determined by the place where the contract is consummated, not by the place where it was perfected (See The Shell Co. of the Phil. v. Municipality of Sipocot, G.R. No. L-12680, March 20, 1959; see also Anglo California National Bank v. Collector, 57 O. G. 3719). This is evident from the very wording of Section 159 of Revenue Regulations No. 2, which provides that the term "the country in which sold" means "the place where the property is marketed."

Consequently, the profit of ₱723,448.35 derived from sales of personal property in the United States by petitioner should be treated as derived entirely from sources within that country because the same was derived by petitioner from the purchase of personal property within and its sale without the Philippines. It follows that petitioner Compañia General de Tabacos de Filipinas is not subject to Philippine income tax upon this profit derived from sources in the United States, pursuant to Section 24 of the Revenue Code. With this conclusion, it becomes unnecessary to pass upon the question of prescription.

WHEREFORE, the appealed decision is hereby reversed without pronouncement as to costs.

SO ORDERED.

Quezon City, November 29, 1966.

ROMAN M. UMALI
Presiding Judge

WE CONCUR:

ESTANISLAO R. ALVAREZ
Associate Judge

RAMON L. AVANCEÑA
Associate Judge