REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

Oct. 29, 1970

PACIFIC BANKING CORPORATION,
Petitioner,

- versus -

C.T.A. CASE No. 1667

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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D E C I S I O N

Petitioner filed this action in court seeking the refund of ₱181,232.00 and ₱151,067.00, or a total of ₱332,299.00, as alleged overpaid corporate income taxes for 1962 and 1963, respectively.

From the stipulation of facts and the evidence adduced in the hearing of the case, it was ascertained that petitioner is a duly organized banking corporation located at 460 Rosario St., Binondo, Manila.

Petitioner filed on time the corporate income tax returns for 1962 and 1963, reporting therein the gross income, net income, and income taxes due from the bank, itemized as follows:

Year	Gross Income	Net Income	Income Tax Due
1962	₱ 8,232,229.93	₱3,490,810.63	₱1,039,243.00
1963	10,964,168.17	4,773,895.96	1,424,169.00

(Exhs. B & E, pp. 10-139, 140-141, Vol. I, BIR rec.)

On the bases of petitioner's books of accounts and records, it paid the corporate income taxes for 1962 and 1963 in the amounts of ₱1,039,243.00 and

₱1,424,169.00 in two equal installments each, computed as follows:

Date of Payment	Amount Paid
April 15, 1963	₱ 519,621.50
July 8, 1963	519,621.50
	₱1,039,243.00
April 15, 1964	₱ 712,084.50
July 15, 1964	712,084.50
	₱1,424,169.00

(Pars. 3-6, Stifacts; Exhs. C, F & G, pp. 139 & 141, Vol. I, BIR rec.; p. 52 CTA rec.; p. 8, t.s.n.)

For 1963, the directors of the board and the executive officers of the bank received salaries and bonuses in the following amounts:

Bonus for 1963

Names	Director	Exec. Officer	Employee	Monthly Salary
1. A. R. Chua	₱36,062.92	Ch. ₱36,062.92 Pres. 42,477.95	₱14,000.00	₱7,000.00
2. C. Babst	32,055.94	VCh. 18,031.46 EVP. 36,409.67	12,000.00	6,000.00
3. J. F. Unson	--	18,204.84	6,000.00	3,000.00
4. Vicente Chua	16,027.96	14,563.87	4,800.00	2,400.00
5. Valentin Chua	--	14,563.87	4,800.00	2,400.00
6. Yao Shiong Shio	16,027.96	--	--	--
7. Santos Chua How	16,027.96	--	--	--
8. F. Lirag	16,027.96	--	--	--
9. C. Lobregat	16,027.96	--	--	--
10. P. Lovina	16,027.96	--	--	--
11. A. Tanunliong	16,027.96	--	--	--
Total -------	₱180,314.58	₱180,314.58	₱41,600.00	₱20,800.00

(Exhs. T & U, pp. 109 & 113, CTA rec.)

Likewise, the staff and employees of the bank received bonuses ranging from 100% to 200% of their monthly salaries. (Exhs. H, I, J, T & U, pp. 53-55 & 109-118, CTA rec.)

On July 12, 1965, petitioner through its external auditors Carlos J. Valdes & Co., filed with respondent Commissioner of Internal Revenue a written claim for refund of the alleged overpaid income taxes for 1962 and 1963 in the amounts of ₱181,232.00 and ₱151,067.00. It was alleged in the said claim that due to the failure of Zialcita & Associates, former external auditors of the bank, to deduct from petitioner's 1962 and 1963 gross income the amount of bonuses corresponding to and paid to its directors, officers and employees, the bank overpaid its corporate income taxes for the said years, computed as follows:

1962

Net income per return ----------	₱3,490,810.63
Less: Bonuses & profit shares of directors, etc.----------	604,106.85
Net taxable income after bonuses-	₱2,886,703.78
Income tax due thereon ----------	858,011.00
Income tax paid ----------------	1,039,243.00
Overpayment ----------------------	₱ 181,232.00

1963

Net income per return ----------	₱4,775,895.96
Less: Bonuses & profit shares of directors, etc. --------	503,556.86
Net taxable income after bonuses-	₱4,270,339.10
Income tax due thereon ---------	₱1,273,102.00
Income tax allegedly paid -------	1,424,169.00
Overpayment ----------------------	₱ 151,067.00

(Exh. A, supra.)

On July 14, 1965, petitioner filed with this Court an action seeking the refund of the alleged overpaid income taxes for 1962 and 1963 without waiting the decision of respondent on its claim for refund. The said court action was instituted beyond the two-year period prescribed by Section 306 of the National Internal Revenue Code because the second installment for the 1962 income tax was paid by petitioner on July 8, 1963.

There are three issues considered by the Court for resolution, namely:

1. Whether or not respondent Commissioner of Internal Revenue has authority to refund the alleged overpaid income tax of ₱181,232.00 for 1962;

2. Whether or not this Court has jurisdiction to take cognizance of petitioner's first cause of action considering the provisions of Section 309 of the Revenue Code, in relation to Section 306 of the same Code; and

3. Whether or not petitioner is entitled to the refund of the alleged overpaid income tax of ₱151,067.00 for 1963.

First Issue:

The income tax due from petitioner for 1962 amounting to ₱1,039,243.00 was paid in two equal installments of ₱519,621.50 each on April 15 and July 8, 1963. Petitioner's claim for refund was, however, filed with respondent only on July 12, 1965. Consequently, respondent has no authority to credit or refund the alleged overpaid income tax for 1962 because petitioner's written claim for refund was filed with respondent two years after payment of the said tax. In short, from the date of the last installment payment on July 8, 1963, petitioner had until July 8, 1965 within which to file with respondent the claim for refund of the alleged overpaid income tax for 1962, in line with Section 309 of the National Internal Revenue Code the pertinent portion of which provides as follows:

> Sec. 309. Authority of Commissioner to make compromises and to refund taxes. xx xx
>
> xx xx xx xx
>
> The authority of the Commissioner of Internal Revenue to credit or refund taxes or penalties under this section can only be exercised if the claim for credit or refund is made in writing and filed with him within two years after payment of the tax or penalty. (Underscoring supplied.)

Petitioner's written claim for refund was, therefore, filed with respondent beyond the two-year period prescribed by Section 309 of the Tax Code, supra. Accordingly, we hold that the respondent Commissioner of Internal Revenue has no legal authority to refund the alleged overpaid income tax of petitioner for 1962.

Second Issue:

When the action for refund was instituted in this Court on July 14, 1965, we have no authority to take cognizance of the said claim for the alleged overpaid 1962 income tax because petitioner's right for the recovery thereof has prescribed under Section 306 of the National Internal Revenue Code which provides as follows:

> Sec. 306. Recovery of tax erroneously or illegally collected.- No suit or proceeding shall be maintained in any court for the recovery of any national internal revenue tax hereafter alleged to have been erroneously or illegally assessed or collected or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Commissioner of Internal Revenue; but such suit or proceeding may be maintained, whether or not such tax, penalty, or sum has been paid under protest or duress. In any case, no such suit or proceeding shall be begun after the expiration of two years from the date of payment of the tax or penalty. (Underscoring supplied.)

The foregoing provisions of the Tax Code are mandatory (Bermejo vs. Collector of Internal Revenue, 87 Phil. 96) and non-compliance therewith is fatal. Thus, in the case of Cebu Portland Cement Co. vs. Collector (now Commissioner) of Internal Revenue, G.R. No. L-20563, October 29, 1968, our Supreme Court held as follows:

> "xx Construing the above provision, this Court has ruled that the two requirements - (1) filing of a written claim for refund with the Commissioner of Internal Revenue; and (2) institution of a suit or proceeding in court within two

years from the date of payment - are mandatory and noncompliance therewith is fatal.[14]"

(14 Johnston Lumber Co., Inc. v. Court of Tax Appeals, G.R. No. L-9292, April 23, 1957; Guagua Electric Light Plant Co., Inv. v. Collector of Internal Revenue, et al., G.R. No. L-14421, April 29, 1961.)

Despite the said ruling, our Supreme Court, in the case of Commissioner of Internal Revenue vs. Priscilla Estate, Inc., et al., G.R. No. L-18282, May 29, 1964, held that the two-year period of limitation under Section 306 of the Tax Code being prescriptive, the same should be pleaded in a motion to dismiss or as a defense in the answer; otherwise, it is deemed waived. Be that as it may, respondent cannot file a motion to dismiss or interpose the defense of prescription in his answer because petitioner failed to state specifically in its petition for review the exact date (day, month and year) when it paid the income tax for 1962. In other words, the procedural and technical defense availed of by petitioner as an argument cannot be invoked where the same petitioner, thru its own fault and negligence, deprived respondent of the chance to assail and dispute petitioner's procedural and technical defense. Moreover, petitioner misled respondent when on page 2 of Annex A of the petition, it was made to appear that petitioner's 1962 income tax was paid on July 15, 1963 instead of July 8, 1963.

Accordingly, we hold that, inasmuch as petitioner's action for refund of a portion of its 1962 income tax has already prescribed under Sections 306 and 309 of the Tax Code, this Court has no jurisdiction to take cognizance of the said claim.

<u>Third Issue</u>:

For 1963, petitioner paid bonuses of ₱180,314.58 to nine (9) members of its board of directors despite the fact that they received per diems amounting to ₱22,650.00. During the same year five (5) executive officers of the bank received bonuses of ₱180,314.58 including the bonuses of the chairman and vice chairman of the board amounting to ₱54,094.38. In addition to the said additional compensation of the five (5) officers, they received bonuses of 200% of their monthly salaries amounting to ₱41,600.00 as <u>employees</u> of the bank.

Messrs. A. R. Chua and C. Babst who are president and executive vice-president of petitioner and chairman and vice-chairman of its board of directors, respectively, were the beneficiaries of four bonuses in 1963, namely: (1) as members of the board, ₱36,062.92 and ₱32,055.94; (2) as officers thereof, ₱36,062.92 and ₱18,031.46; (3) as executive officers of the bank, ₱42,497.95 and ₱36,409.67; and (4) as employees thereof,

₱14,000.00 and ₱12,000.00, respectively. In 1962, Messrs. Chua and Bebst received a monthly salary of ₱3,000.00 and ₱4,500.00, whereas in 1963 their monthly salaries were increased to ₱7,000.00 and ₱6,000.00, or an increase of 133-1/3% and 33-1/3%, respectively. In terms of cash, Mr. Chua received an additional compensation of ₱48,000.00 per annum while Mr. Bebst received ₱18,000.00 increase for the same period.

The bonuses paid by petitioner for 1963 amounted to ₱503,556.86, itemized as follows:

1. Nine (9) members of the board of directors ---------------------₱180,314.58
2. Five (5) executive officers of the bank including the chairman and vice-chairman of the board ------------------------ 180,314.58
3. Employes of the bank including five executive officers -------- 142,927.70
   TOTAL ------------------------₱503,556.86

Petitioner as employer has the right to fix the compensation of its officers and employes and pay the bonuses in question. For income tax purposes, however, the said employer cannot legally deduct bonuses from gross income unless they are shown to be reasonable expenses. To hold otherwise would open the gate to rampant tax evasion (Kuenzle & Streiff, Inc. vs. Commissioner of Internal Revenue, G.R. No. L-18840, May 29, 1969). In short, the right of petitioner to fix the salaries and bonuses of its officers is not absolute where the same was availed of to avoid payment of corporate income tax due to the Government. (C. M. Hoskins & Co., Inc. vs. Commissioner of Internal Revenue, G. R. No. L-24059, Nov. 28, 1969.)

The pertinent provisions of the National Internal Revenue Code applicable to the case at bar read as follows:

> 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.

In construing and applying the foregoing statutory provisions, our Supreme Court has consistently laid down the rule that bonuses as business expenses are deductible from gross income provided that:

1. The payment of the bonuses is in fact compensation;

2. The payment is made for personal services actually rendered; and

3. The bonuses, when added to salaries, are reasonable.

Our Supreme Court in a number of cases held as follows:

> It is a general rule that "bonuses to employees made in good faith and as additional compensation for the services actually rendered by the employees are deductible, provided such payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered" (4 Mertens, Law of Federal Income Taxation, Sec. 25.50, p. 410). The condition precedent to the deduction of bonuses to employees are: (1) the payment of the bonuses is in fact compensation; (2) it must be for personal services actually rendered; and (3) the bonuses, when added to the salaries, are "reasonable" x x x when measured by the amount and quality of the service performed with relation to the business of the particular taxpayer (Idem., Sec. 25.44, p. 395). x x x. (Kuenzle & Streiff, Inc. v. Coll. of Int. Rev., 106 Phil. 355; see also Kuenzle & Streiff, Inc. v. Comm. of Int. Rev., G.R. No. L-18840, May 29, 1969; C. M. Hoskins & Co., Inc. v. Comm. of Int. Rev., G.R. No. L-25059, Nov. 28, 1969.)

In reiterating the foregoing doctrine, our Supreme Court entrusted to the lower court the determination of whether or not the requisites prescribed by Section 30(a)(1) of the National Internal Revenue Code have been complied with. Thus, it was held:

> In the light of the tenor of the foregoing provision, whenever a controversy arises on the deductibility, for purpose of income tax, of certain items for alleged compensation of officers of the taxpayer, two (2) questions become material, namely: (a) Have "personal services" been "actually rendered" by said officers? (b) In the af-

> firmative case, what is the "reasonable allowance" therefore? When the Collector of Internal Revenue disallowed the fees, bonuses and commissions aforementioned, and the company appealed therefrom, it became necessary for the lower court to determine whether said officer had correctly applied section 30 of the Tax Code, and this, in turn, required the consideration of the two (2) questions already adverted to. (Alhambra Cigar & Cigarette Mfg. Co. v. Coll. of Int. Rev., 105 Phil. 1337; see also Alhambra Cigar & Cigarette Mfg. Co. v. Comm. of Int. Rev., G.R. No. L-23226, Nov. 28, 1967.)

The burden of proof that the salaries and bonuses are deductible from gross income devolves solely upon the taxpayer. The reasonableness of the said compensation is a question of fact which must be proven to the satisfaction of the court; otherwise, the same may be disallowed as a deduction from gross income in determining the net taxable income of a taxpayer. (Allie M. Tuberville, 31 B.T.A. aff'd 84F(2d) 307; Edgar Carnick, 21 B.T.A. 12,21; National Contracting Co., 37 B.T.A. 689, aff'd 105F(2d) 488.)

Directors' fees of ₱180,314.58 plus ₱54,094.38 paid to the chairman and vice-chairman of the board are excessive and unreasonable.

The by-laws of the bank authorize the payment of bonuses to its (1) executive officers and (2) board of directors at the rate of 5% of the annual profits or net earning of the bank for each group, or a total of 10% amounting to ₱360,629.16 without specifying the basis for the grant of the said bonuses. (See Exh. K-1, p. 63, CTA rec.)

In the case at bar, there is no dispute that in 1963 the members of the board of directors were paid per diems amounting to ₱22,650.00. To justify the additional compensation of ₱180,314.58 for the nine (9) members of the board plus ₱54,094.38 to the chairman and vice-chairman thereof who were already given bonuses as members thereof, it is incumbent upon petitioner to prove that the said bonuses are reasonable in order that the same may be allowed as deductible expenses from petitioner's gross income. Petitioner, however, failed to do so. The evidence of record shows that the board held regular meetings once a month and such special meetings as may be called by the chairman or three members of the board. The agenda of the meetings, duration, and importance of the business taken by the board were not submitted to the court for its evaluation. Neither was there any evidence showing that the activities of the board contributed to the realization of petitioner's huge profit. Consequently, the said directors' fees of ₱180,314.58 cannot be considered as an ordinary and necessary expense in carrying on the business of the taxpayer, including reasonable allowance for salaries, within the purview of Section 30(a) of the Revenue Code, supra. At any rate, as the board of directors is vested with the management of the ordinary corporate affairs of the bank, the amount of ₱45,300.00 representing an additional 200% per diems may be allowed as a deductible expense from petitioner's gross income in 1963. With the allowance of said expense, the extra bonus of ₱54,094.38 for the chairman and vice-chairman of the board is hereby disallowed since they are entitled to additional bonuses as president and executive vice-president of the bank, aside from their salary increases of ₱48,000.00 and ₱18,000.00 per annum, respectively.

<u>Bonuses of ₱126,220.20 for five (5) executive officers of the bank are excessive and unreasonable</u>.

In 1963, Messrs. A. R. Chua, C. Babst, J. F. Unson, Vicente Chua and Valentin Chua were given bonuses of ₱42,447.95, ₱36,409.67, ₱18,204.84, ₱14,563.87 and ₱14,563.87, respectively. In the same order, their salary increases for 1963 amounted to ₱48,000.00, ₱18,000.00, ₱6,000.00, ₱3,600.00 and ₱4,800.00, or a total of ₱80,400.00.

The foregoing five executive officers of the bank were not presented to this Court to testify as to the reasonableness of their additional compensation amounting to ₱126,220.20. This Court was not, therefore, given the opportunity to evaluate the reasonableness of the deductible expense. Insofar as Mr. A. R. Chua is concerned, president and controlling stockholder of the bank, the additional compensation given to him appears to be a distribution of cash dividend and, therefore, the Court is constrained to fix for him a reasonable compensation for income tax purposes. Considering that in 1963, he was given a salary increase of ₱48,000.00 compared with the disproportional increase of the other executive officers of the bank, it is felt that the amount of ₱14,000.00 which is equivalent to 200% of his increased monthly salary, or a total of ₱62,000.00 as additional compensation, may be considered liberal and still reasonable. With respect to the four other executive officers, namely: Messrs. C. Babst, J. F. Onson, Vicente Chua and Valentin Chua, this Court believes that the amountsof ₱18,000.00, ₱9,000.00, ₱7,200.00 and ₱7,200.00, respectively, which is equivalent to 300% of their monthly salaries is deemed fair and reasonable. Consequently, the total amount of ₱55,400.00 may be allowed as a deduction from petitioner's gross income. After fixing the reasonable amount of bonuses of the five executive officers of the bank, we decided to disallow the additional two-month salary bonuses of ₱41,000.00 which is excessive and unreasonable under the facts and circumstances of the case.

Bonuses of ₱101,327.70 paid to the staff and employees of the bank are reasonable.

The bonuses of ₱101,327.70 paid to the staff and employees of the bank are reasonable. But what is a reasonable compensation is not defined by any fixed rule in the law. On this point, however, our Income Tax Regulations provide:

> Sec. 70. Compensation for personal services. xx xx
> (3) In any event the allowance for compensation paid may not exceed what is reasonable in all the circumstances. It is in general just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises in like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.

The staff and employees of the bank were given bonuses of 100%, 125%, 150% and 200% of their monthly salaries depending upon the length of their services and status of their employment. In fact, those who occupied permanent positions and were old in the service were given bigger bonuses than those who served the bank for a shorter period. The said grant of bonuses is a common practice among business, commercial, industrial, and other firms by way of inducement for better and efficient service of their staff and employees thereby enhancing and promoting the success of the business venture.

The successful operation of petitioner's business is reflected in the steady increase of its annual and net income, the substantial profits realized by the bank from year to year, and the adequate returns to its investment even after payment of the bonuses. Consequently, we hold that the bonuses of ₱101,327.70 paid to petitioner's staff and employees are fair and reasonable and the same may be deducted from petitioner's 1963 gross income.

In resumé, the following expenses are deductible from petitioner's 1963 gross income, namely:

1.	Additional directors' per diems of 200%	₱45,300.00
2.	Bonuses of five executive officers, 200% to 300%	55,400.00
3.	Bonuses to staff and employees, 100% to 200%	101,327.70
	Total	₱202,027.70

Respondent's pretension and defense that the bonuses and additional compensation in question are not deductible from petitioner's 1963 gross income because they were in reality distribution of earnings under the profit sharing plan, suffice it to state that the said defense becomes untenable after the Court has ascertained and fixed the reasonableness of the additional compensation of petitioner's directors, officers, and employees. Moreover, the form or method of fixing compensation is not decisive as to the deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. (Sec. 70, Revenue Regulations No. 2.)

After considering the deductible expenses of petitioner from its 1963 gross income which failed to include the items here in dispute, the amount of ₱202,027.70 may, therefore, be deducted from petitioner's net income resulting in overpayment, computed as follows:

1 9 6 3

Net income per return --------	₱4,773,895.96
Less: deductible bonuses ----	202,027.70
Net taxable income after bonuses ------------------	₱4,571,868.26
Income tax paid by petitioner ------------------	₱1,424,169.00
Income tax due from petitioner ------------------	1,363,560.00
Overpayment ----------------	₱ 60,609.00

WHEREFORE, petitioner is declared entitled to a refund or tax credit of overpaid 1963 income tax in the amount of ₱60,609.00. Accordingly, respondent Commissioner of Internal Revenue is hereby ordered to refund to or credit petitioner the said amount of overpayment. No costs.

SO ORDERED.

Quezon City, October 29, 1970.

ESTANISLAO R. ALVAREZ
Associate Judge

WE CONCUR:

ROMAN M. UMALI
Presiding Judge

RAMON L. AVANCEÑA
Associate Judge