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PACIFIC TRANSPORT LINES, INC.
and its successor, STATES
STEAMSHIP COMPANY,
Petitioner,

- versus -

CTA CASE NO. 1039

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

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

4/29/81

D E C I S I O N

This is an appeal contesting the decision of respondent Commissioner of Internal Revenue dated February 8, 1961 and holding petitioner liable for deficiency income tax for the years 1951, 1952 and 1953 in the amounts of ₱44,560.00, ₱4,177.00 and ₱42,875.00, respectively.

This appeal also involves a claim for the refund of ₱43,816.00 as allegedly overpaid income tax for the year 1955.

Petitioner is a foreign shipping company organized under the laws of the State of California, U.S.A. Petitioner's first agent is the Everett Steamship Lines, Inc., until 1955, when the agency was transferred to the Dodwell & Co. in Manila. (P.11, BIR rec.)

For the taxable years 1951, 1952, 1953 and 1955, petitioner had filed its income tax returns with the office of respondent in the month of April of the taxable year covered by each of the said returns. (Par. 2, Petition for Review; Admitted, Par. 2, Answer.)

On the dates stated below, petitioner received the assessment notices for alleged deficiency income tax for the years involved as follows:

Date of receipt of assessment	Assessment No.	Year Covered	Amount
March 8, 1957	ACR-1303-56/51	1951	₱673,425.00
April 1, 1957	ACR-1287-56/55	1955	538,015.00
April 24, 1957	ACR-1053-56/52	1952	889,297.00
April 24, 1957	ACR-1103-56/53	1953	906,509.50

(Paragraphs 3, 5, 7, Petition; Admitted, paragraphs 3, 5 & 7, Answer; pp. 24, 93, 70, 53 respectively, BIR rec.)

The above assessments were arrived at on the theory that herein petitioner was not duly licensed to do business in the Philippines but its vessels touched ports in the Philippines and, therefore, it should be considered a non-resident foreign corporation not engaged in trade or business in the Philippines, hence, not entitled to deduct expenses allocable to income derived from sources within the Philippines.

On March 15, 1957, petitioner contested the assessment for 1951 (Paragraph 4, Petition: Admitted, Paragraph 4, Answer); the assessment for 1955 was likewise contested by petitioner in its letter dated April 3, 1957 (Paragraph 6, Petition, Admitted, Paragraph 6, Answer); while the assessments for the years 1952 and 1953 were contested in its letter dated April 25, 1957 (Paragraph 8, Petition; Admitted, Paragraph 6, Answer.)

On January 15, 1958, respondent ordered the reinvestigation of the above-stated income tax liabilities of petitioner (p. 105, BIR rec.) and, as a consequence thereof, in a Memorandum to the Chief, Manila Examiners, dated December 16, 1958, respondent's Examiner Bernardino Enerio submitted his report finding that petitioner is a foreign corporation doing business in the Philippines thereby reversing the original theory that petitioner is not entitled to deduct expenses allocable to income derived from sources within the Philippines. It was determined however, that petitioner has still incurred deficiency taxes in the total amount of ₱135,428.00. (Exh. 7, Respondent, p. 160-162, BIR rec.)

On this basis, respondent, on August 13, 1959, assessed and demanded from petitioner payment of deficiency income tax for the years 1951, 1952, 1953 and 1955 as follows:

ACR-1303-59/51

Philippine Gross Income	₱2,682,781.12
Less: Philippine Expenses	2,274,522.04
Net Income per investigation	₱ 408,259.08
Amount subject to tax	408,259.08
Tax due thereon	₱ 106,313.00
Less: Amount already assessed	61,753.00
DEFICIENCY TAX DUE & COLLECTIBLE	₱ 44,560.00

ACR-1053-59/52

Philippine Gross Income	₱2,145,231.62
Less: Philippine Expenses	2,124,345.24
Net Income per investigation	₱ 20,885.38
Amount subject to tax	20,885.38
DEFICIENCY TAX DUE & COLLECTIBLE	₱ 4,177.00

ACR-1103-59/53

Net income per return	₱ 92,693.34
Add: Undeclared income	155,212.80
Net income per investigation	₱ 247,906.14
Amount subject to tax	247,906.14
Tax due thereon	₱ 61,414.00
Less: Amount already assessed	18,539.00
DEFICIENCY TAX DUE & COLLECTIBLE	₱ 42,875.00

ACR-1287-59/55

Philippine Gross Income	₱1,997,156.48
Less: Philippine Expenses	1,745,169.52
Net income per investigation	₱ 251,986.96
Amount subject to tax	251,986.96
Tax due thereon	₱ 62,556.00
Less: Amount already assessed	18,740.00
DEFICIENCY TAX DUE & COLLECTIBLE	₱ 43,816.00

(Exh. 9, resp. pp. 180-181, BIR REC.)

The deficiency assessment this time arose from the alleged understatement of petitioner's world income in its income tax returns for the years in question.

On October 5, 1959, petitioner disputed the aforementioned assessment and assailed the right of respondent to assess deficiency income tax for the years 1951, 1952 and 1953 on the ground of prescription. Thus, in the case of its income tax return for 1953, petitioner claimed that the return, was filed in April, 1954 so that the prescriptive period expired in April, 1959. (Exh. 10, Respondent, pp. 184-186, BIR rec.)

Petitioner also argued that it paid the deficiency income tax assessment for 1955 on October 15, 1959, in the amount of ₱43,816.00 under O.R. No. A-883371. (Paragraph 11, Pet. Admitted, Paragraph 6, Answer.)

On January 18, 1960, the Deputy Commissioner of Internal Revenue, Misael P. Vera, wrote the tax advisers of petitioner, Messers. Sycip,Gorres,Velayo & Co. that a reconsideration of the bases of petitioner's tax liabilities as called for in its letter to respondent dated October 5, 1959 can only be made upon execution by petitioner of the waiver of the defense of prescription. (P. 205, BIR rec.) Thus, on September 7, 1960, petitioner executed a waiver of the statute of limitation with a provision that petitioner reserves the right to maintain and pursue at all times the defense of prescription which it has set up against the foregoing assessments. (Exh. 11, Respondent, pp. 212-213, BIR rec.)

A supplemental protest dated October 4, 1960 was filed by petitioner on October 5, 1960, requesting for the cancellation of the assessment in question on the ground that respondent's right to assess and collect the alleged deficiency income taxes for the years 1951, 1952 and 1953 had already prescribed. (Pp. 215-219, BIR rec.)

Finally, respondent on February 8, 1961, denied petitioner's request for cancellation and withdrawal of the assessment. (Exh. 12, pp. 221-223, BIR rec.)

On April 11, 1961, petitioner filed a claim for refund with respondent (Pp. 226-227, BIR rec.) and filed its petition for review with this Court on the same date.

Shortly, after the filing of this appeal, respondent issued a warrant of distraint and levy to enforce collection of the deficiency tax assessment.

On July 13, 1961, petitioner filed a "Motion To

Quash Warrant of Distraint and Levy and to Enjoin Collection of Taxes" and on March 31, 1962, this Court rendered a resolution granting petitioner's motion to quash Warrant of Distraint and Levy subject to the condition that petitioner files with this Court a surety bond. On March 26, 1962, petitioner filed a surety bond to guarantee payment of the deficiency taxes, posted by the Commonwealth Insurance Company.

The issues therefore to be decided by this Court are as follows:

1. Whether or not the right of respondent to assess and collect the deficiency income tax for the years 1951, 1952 and 1953 has already prescribed;

2. Whether or not the deficiency assessments for said years are correct and in accordance with law; and

3. Whether the deficiency income tax for 1955 in the amount of ₱43,816.00 and paid by petitioner on October 15, 1959 under O.R. No. A-883371 was assessed and collected in accordance with law and, therefore, petitioner is not entitled to a refund of the amount paid by it.

We will now come to the first issue. The law on prescription involved in this case is found in Sections 331, 332 and 333 of the Tax Code at the time, stating as follows:

SEC. 331. Period of limitation upon assessment and collection. - Except as provided in the succeeding section, internal revenue taxes shall be assessed within five years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period. For the purposes of this section a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day: Provided, That this limitation shall not apply to cases already investigated prior to the approval of this Code.

SEC. 332. Exceptions as to period of limitation of assessment and collection of taxes. - (a) In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any ti e within ten years after the discovery of the falsity, fraud, or omission.

(b) Where before the expiration of the time prescribed in the preceding section for the assessment of the tax, both the Commissioner of Internal Revenue and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time, prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

(c) Where the assessment of any internal revenue tax has been made within the period of limitation above-prescribed, such tax may be collected by distraint or levy or by a proceeding in court, but only if begun (1) within five years after the assessment of the tax, or (2) prior to the expiration of any period for collection agreed upon in writing by the Commissioner of Internal Internal Revenue and the taxpayer before the expiration of such five-year period. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

> SEC. 333.- Suspension of running of statute.- The running of the statute of limitations provided in section 331 or 332 on the making of assessment and the beginning of distraint or levy or a proceeding court for collection, in respect of any deficiency, shall be suspended for the period during which the Commissioner of Internal Revenue is prohibited from making the assessment or beginning distraint or levy or a proceeding in court and for sixty days thereafter.

Petitioner contends that the right of the government to assess and collect the deficiency income tax for the years 1951, 1952 and 1953 has already prescribed. Respondent, on the other hand, maintains that the petitioner is estopped from raising the defense of prescription because it voluntarily filed a written "Waiver of the Defense of Prescription" on September 7, 1960. Respondent cites the case of Santiago Sembrano vs. Court of Tax Appeals and Collector of Internal Revenue, G.R. No. L-8652, March 30, 1957, 101 Phil. 1-15. He further intimates that an assessment could have been issued within the statutory period had the local agent of petitioner not misled the respondent into holding or delaying the assessment of the tax by virtue of petitioner's representation to consult with its principal, citing the case of the Collector of Internal Revenue vs. Suyoc Consolidated Mining Co., et al., G.R. No. L-11527, Nov. 25, 1958.

The Court agrees with petitioner that the right of respondent to assess and collect the deficiency income taxes in question has prescribed. It is to be noted that petitioner had filed its income tax return in the month of April corresponding to each of the taxable years 1951, 1952 and 1953 and, accordingly, the five-year period prescribed by law to assess the tax for said years shall prescribe in the month of April, 1957, 1958 and 1959, respectively. Since the assessment for the years 1951, 1952 and 1953 were issued only on August 13, 1959, the right of respondent to assess the taxes is already barred by the statute of limitation. Hence, even assuming that the amounts demanded under assessment notices Nos. ACR-1303-59/51, ACR-1053-59/52, ACR-1103-59/53, all dated August 13, 1959, are legally due from petitioner, the same may no longer be collected.

In the instant case, it is our finding <u>firstly</u>, that no provision of law or effective agreement was cited by respondent to show that he was prohibited from making the assessment in 1957, or sometime thereafter. Secondly, respondent issued in 1957 merely a proposed (tentative) deficiency tax assessment against petitioner, on the erroneous belief that petitioner was not licensed to do business in the Philippines instead of a final deficiency tax assessment. The voluntary and unilateral act of respondent in inviting petitioner to air its objections to the proposed assessment cannot be construed to suspend the period within which to assess the tax. (Dupro Philippines, Inc. vs. Comm. of Int. Rev., CTA Case No. 1341, Dec. 16, 1968.)

Moreover, an assessment that has been set aside or cancelled is not assessment at all. Where an assessment is made within the five-year period but was set aside or modified by another, the five -year period within which to assess in section 331 of the Internal Revenue Code is to be counted from the date of the filing the return to the date the new assessment was made. (Pineda vs. Coll. of Int. Rev., G.R. No. L-14522, May 31, 1961; 2 SCRA 401.)

Respondent, however, insists that the request of the agent of petitioner, Dodwell & Co., to consult with its principal with respect to the proposed assessment had the effect of persuading the respondent to postpone the assessment of the deficiency tax. Nowhere does the law recognizes the fact that a simple request, such as in the instant case, unaccompanied by any positive act indicating that the petitioner waives his right to assert the defense of prescription, has the effect of postponing the right of the respondent to assess. (Coll. of Int. Rev. vs. Suyoc Consolidated Mining Co., et al., G.R. No. L-11527, Nov. 25, 1958.)

The case which respondent cited as authority to sustain his contention that the petitioner has waived the defense of prescription is not in point. In the case of Santiago Sembrano vs. Court of Tax Appeals & Collector of Internal Revenue (now Commissioner of Internal Revenue), G.R. No. L-8652, March 30, 1957, petitioner therein, Santiago Sembrano, was assessed ₱184,241.08 on April 28, 1951, for income, percentage and residence taxes for 1945 to 1948, and percentage tax from 1939 to 1941, inclusive of surcharge and penalties. Instead of contesting the assessment, petitioner Sembrano paid ₱17,929.40, and executed a chattel mortgage on 67 of his TPU buses to secure payment of his obligation, and tried to execute another mortgage covering 20 buses, although this was not approved by the Public Service Commission. Upon failure to comply with the conditions of the mortgage, the Collector of Internal Revenue issued a warrant of distraint and levy on September 27, 1952 and seized 63 auto-buses of said petitioner to be sold for the satisfaction of its tax obligations. The sale was however, suspended when petitioner proposed to make substantial payment but who later on failed to comply therewith. The Collector then set the sale of petitioner's properties, and petitioner promptly filed a petition before the Court of Tax Appeals to enjoin the sale. In the instant case, which is different from the case first cited, the assessments were duly and seasonably protested, and the defense of prescription was fully asserted. While petitioner had executed a waiver of the statute of limitation, it was with the condition that it reserved its right to maintain and pursue at all times the defense of prescription which it has already set up against the assessments.

Moreover, this Court has already ruled that the period of prescription can only be extended before the expiration of said period. Thus, in Rattan Art & Decorations, Inc. vs. Collector of Internal Revenue, CTA Case No. 567, promulgated August 1, 1960, this Court said:

> "But it is alleged that petitioner expressly waived the statute of limitation prescribed in Sections 331 and 332 on September 19, 1955. Section 332(b) provides:
>
> > '(B) Where before the expiration of the time prescribed in the preseding section for the assessment of the tax both the Collector of Internal Revenue and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed any time prior to the expiration of the period agreed upon. The period agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.'
>
> "It will be observed that the period of limitation upon assessment may be suspended under Section 332(b) if the agreement is made before the expiration of the period fixed in Section 331. In this case, the agreement was entered into between petitioner and the Commissioner of Internal Revenue on September 19, 1955, after the period for assessment of the deficiency sales tax for the year 1949 and first quarter of 1950 had already lapsed. The agreement is, therefore, ineffective as to such period. x x x"

And, in the case of Suyoc Consolidated Mining Co., *Supra*, the taxpayer therein has been found to have, by positive acts, induced respondent to suspend the collection of the tax assessed against it. On the other hand, in the present case, at no time did petitioner induced, by positive acts, the respondent to delay the assessment. The local agent of petitioner had merely requested respondent that it be furnished with the computation of the deficiency income tax for 1951, 1952, 1953 and 1955 for the purpose of transmitting it to its principal and to have a basis for conference upon receipt of its principal's reply. It will be noted also that in the above cited case of Suyoc, it is the right of the respondent to collect (not the right to assess) which has been held barred by prescription.

Certainly, the allegation then of respondent that the assessment could have been issued by him well within the statutory period had the local agent of petitioner not misled him into holding and delaying the assessment of the tax by virtue of petitioner's agent representation to consult with its principal, is without merit. It is sufficient to state that petitioner had a perfectly legitimate right to consult with its principal and this act will not suffice to stop it from invoking the statute of limitation. (Coll. of Int. Rev. vs. Pineda, 2 SCRA 402.) Finally, it is always incumbent upon respondent to take the necessary measures and steps to prevent the setting of prescription of his right to assess and collect taxes.

Having disposed of the first issue on prescription adverse to respondent, we find it unnecessary to determine the related question of whether or not the assessments for 1951, 1952 and 1953 are correct and in accordance with law.

With respect to the last issue, i. e., whether the 1955 assessment for deficiency income tax in the amount of ₱43,816.00 and paid by petitioner on October 15, 1959 under O.R. No. A883371 was in accordance with law and, therefore, petitioner is not entitled to a refund of the amount paid by it, the Court believes that the assessment was wrong and the amount paid therefor is refundable to petitioner.

Petitioner maintains in connection with this issue that in the apportionment of a part of the world expense of the Philippine operations, it is erroneous to include as part of "world gross income" the amounts which are clearly from sources without the Philippines and clearly bear no relationship to the expense being allocated or apportioned.

Respondent, on the other hand, contends that the deficiency tax paid for 1955 should be computed in accordance with the formula of general apportionment prescribed under Section 37(e) of the Tax Code and implemented by Section 163 of Revenue Regulation No. 2. And under the provision of Section 163 of the Income Tax Regulation No. 2 and its accompanying formula, nothing therein implies that the denominator "world gross income" is strictly limited to income partly within andpartly without the Philippines. Thus, it is argued that "world gross income" connotes all kinds of income of foreign shipping companies whose vessels touch Philippine ports irrespective as to whether or not such income is derived from sources outside or inside the Philippines, or partly within and partly without the Philippines. Moreover, assuming that the denominator "world gross income" refers exclusively to income partly derived within and partly without the Philippines, petitioner failed to present evidence showing that the above-mentioned items were indeed income obtained exclusively outside the Philippines.

Verily, the view of respondent is not well taken. The question involved is not of first impression. In several cases, to wit: States Steamship Company vs. Commissioner of Internal Revenue, CTA Case No. 1401, July 16, 1975; Daiichi Chuo Kisen Kaisha vs. Commissioner of Internal Revenue, CTA Case No. 1277, May 31, 1969; United States Lines Company vs. Commissioner of Internal Revenue, CTA Case No. 1305, June 28, 1973; Ginn & Company vs. Commissioner of Internal Revenue, CTA Case No. 674, May 21, 1962 and Holland East Asia Lines vs. Collector of Internal Revenue, CTA Case No. 383, August 5, 1958, this Court has ruled on the interpretation of Section 37 and the implementing income tax regulation.

Thus, in States Steamship Company case, supra, our Court held:

> "Section 37 of the National Internal Revenue Code classified income of foreign corporations into three categories, to wit: (1) income which is derived in full from sources within the Philippines; (2) income which is derived in full from sources without the Philippines; and (3) income which is derived partly from sources within and partly from sources without the Philippines.
>
> Non-resident foreign corporations, like petitioner herein, are taxable only on income from sources within the Philippines, whether derived exclusively from sources within the Philippines or partly from sources within and partly from sources without the Philippines provided they are allocable to sources within the Philippines. (Daiichi Chuo Kisen Kaisha v. Comm of Internal Revenue, CTA Case No. 1277, May 31, 1969; U.S. LinesCompany v. Commissioner of Internal Revenue, CTA Case No. 1305, June 28, 1973; Ginn and Company v. Commissioner of Internal Revenue, CTA Case No. 674, May 21, 1962; Holland East Asia Lines v. Coll. of Int. Rev., CTA Case No. 383, August 5, 1958.) Needless to say, income of petitioner derived in in full from sources outside the Philippines is not, therefore, subject to the Philippine income tax, pursuant to Section 37(c) of the

Tax Code which provides as follows:

> SEC. 37. Income From Sources Within the Philippines. -
>
> x x x x x x x x x
>
> (c) Gross Income From Sources Without the Philippines. - The following items of gross income shall be treated as income from sources without the Philippines:
>
> (1) Interest other than that derived from sources within the Philippines as provided in paragraph (2) of subsection (a) of this section;
>
> (2) Dividends other than those derived from sources within the Philippines as provided in paragraph (2) of subsection (a) of this section;
>
> (3) Compensation for labor or personal services performed without the Philippines;
>
> (4) Rentals or royalties from property located without the Philippines or from any interest in such property, including rentals or royalties for the use of or for the privilege of using without the Philippines, patents, copyrights, secret processes and formulas, goodwill, trademarks, trade brands, franchises, and other like properties; and
>
> (5) Gains, profits, and income from the sale of real property located without the Philippines."
>
> (See also Section 158 of Income Tax or Revenue Regulations No. 2).

Petitioner received the agency fees, commissions and other shipping income from agency services for other steamship lines in its several offices in the United States (Exh. P at p. 95, CTA rec.): the interest income was earned from Government securities and time deposits in the United States; and the other net income was realized from the gains on sales of fixed assets in the United States (Ibid, p. 94.) CTA rec.; see also exh. I, pp. 384-385, CTA rec.);

the proceeds of insurance taken on the life of Eric Wroldsen and refund of Federal Income tax were derived in full from sources outside the Philippines. (Ibid, p. 95, CTA rec., ibid, pp. 384-385, CTA rec.)

Under the provisions of Section 37 of the Tax Code, as implemented by Section 158 of the Income Tax Regulations, the income mentioned above should not be included in the gross income of petitioner for the purpose of determining its Philippine income under Section 163 of the Income Tax Regulations because, if an item of income emanated actually from sources within or without the Philippine under the provisions of Section 37(a) and (c) of the Tax Code, then Section 37(e) and Section 163 of the Income Tax Regulations above-mentioned will no longer apply (United States Lines v. Commissioner of Internal Revenue, supra.) as the said income are not subject to allocation or apportionment to sources within or without the Philippines.

As to the allegation of respondent that petitioner failed to present evidence showing that the above-mentioned items were indeed income obtained exclusively outside the Philippines, suffice it to state that George G. Little, Asst. Secretary-Treasurer of States Steamship Company at the time he testified, explained the nature of the items in question when he appeared before the Philippine Consul at the Consular District of San Francisco, California, U. S. A. (Please see, pp. 162-165, CTA rec.) No cross-interrogations were submitted by respondent. Also, at the hearing of this case before the Court, no evidence was presented rebutting the testimony of George G. Little. Needless to say, the testimony of the witness for petitioner identified the items in question as earned outside of the Philippines and had nothing to do with Philippine operations.

Therefore, since these items were clearly identified as earned outside the Philippines, they should not be included in the "world gross income".

WHEREFORE, the decision of respondent Commissioner of Internal Revenue appealed from is hereby reversed, and the respondent is hereby ordered to refund or grant a tax credit to petitioner the amount of ₱43,816.00 representing erroneously paid income tax for the year 1955. No Costs.

SO ORDERED.

Quezon City, April 29, 1981.

CONSTANTE C. ROAQUIN
Associate Judge

WE CONCUR:

AMANTE FILLER
Presiding Judge

ALEX Z. REYES
Associate Judge