TAXATION

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As in aerial survey, this review takes a broad view of the field of taxation in order to fix present bearings from principles and doctrines already marked and mapped; looks closely for any contour changes; and finally up-dates "topographical" data and information in taxation to reliably guide taxpayers, investors, revenue collectors and tax scholars alike.

This survey follows by and large the traditional classification of taxes according to subject and accordingly reviews the cases as they fall under each classification. Particular attention is directed towards any trend that veers away from established ones. For purposes of easy reading, however, headings suggested by the frequency of cases decided have been added, in disregard of the tax classification. Thus, jurisdiction, assessment and collection, refund rights, customs cases, local taxation, review powers of the Supreme Court, etc. have been discussed as separate categories, cutting across different kinds of taxes.

It is hoped that the reader will thus profit more from this treatment.

I. INCOME TAX

A. *Improper accumulation*

Since 1939 the National Internal Revenue Code has imposed a surtax on the undistributed portion of the accumulated corporate profits or surplus.[1] The tax is rather high, 25%, and is in addition to the regular income tax imposed on corporations by section 24, Tax Code.

The "purpose of the tax is to deter the shareholders of a corporation from avoiding the individual income tax by having the corporation accumulate earnings beyond its business needs, rather than distributing such unneeded earnings as dividends."[2]

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[1] Tax Code, Sec. 25.

[2] Ziegler, *The "New" Accumulated Earnings Tax*, 22 TAX L. REV. 77 (1966).

Our Tax Court has stated that "it is a prerequisite to the imposition of the tax that the corporation be formed or availed of for the purpose of avoiding the income tax on its stockholders by permitting the earnings and profits of the corporation to accumulate instead of dividing them among or distributing them to the stockholders."[3] This requirement has become known as the "subjective test" for it is based on the motives of the shareholders — whether or not they formed or availed of the corporation for the prohibited purpose. Section 25, Tax Code, further provides:

> "(c) *Evidence determinative of purpose.* — The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the tax upon the shareholders or members unless the corporation, by clear preponderance of evidence, shall prove the contrary."

This last paragraph of section 25 creates a presumption establishing the prohibited purpose if the earnings or profits are allowed to accumulate beyond the reasonable business needs of the corporation. This has become known as the "objective test" for reasonableness can be tested objectively.[4]

There is a dearth in our jurisprudence of cases involving section 25, despite its presence in the Tax Code for over a quarter of a century. For the first time, the Supreme Court in 1967 construed this provision in the case of *Basilan Estates, Inc. v. Commissioner of Internal Revenue.*[5]

Among other issues raised was the question of whether or not the surplus of ₱347,507.01 as of Dec. 31, 1953, was unreasonably accumulated for being beyond the needs of the business. The Commissioner of Internal Revenue concluded that it was because of these circumstances:

> "1. Strong financial position of the petitioner as of December 31, 1953. Assets were ₱388,617 while the liabilities amounted to only ₱61,117.13 or a ratio of 6:1.
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> "2. As of 1953, the corporation had considerable capital adequate to meet the reasonable needs of the business amountting to ₱327,499.69 (assets less liabilities).

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[3] Bicol Trading. Inc. v. Commissioner of Internal Revenue, CTA Case No. 612, Jan. 8, 1962, 7 Phil. Tax J 718 (1962).

[4] See note 2, *supra.*

[5] G.R. No. 22492, September 5. 1967.

"3. The ₱200,000 reserved for electrification of drier and mechanization and the ₱50,000 reserved for malaria control were reverted to its surplus in 1953.

"4. Withdrawal by shareholders of large sums of money as personal loans.

"5. Investment of undistributed earnings in assets having no proximate connection with the business — as hospital building and equipment worth ₱59,794.12.

"6. In 1953, with an increase of surplus amounting to ₱677,232.01, the capital stock was increased to ₱500,000 although there was no need for such increase."

The Supreme Court agreed with the respondent that the corporation accumulated its earnings beyond the reasonable needs of its business and therefore upheld the imposition of the penalty tax of 25%. It disregards taxpayer's explanations of the various grounds used above by the Commissioner of Internal Revenue to arrive at his assessment. Thus, as to item No. 3, above, taxpayer stated that the ₱250,000 reverted to its general fund in 1953 was used partly to build factory site and buildings to house technical men, and part was spent in facilities for waterworks system and for industrialization. The Supreme Court brushed this explanation aside as insufficient because this intention was not shown in the records as cause of the accumulation. It stated:

"If there were any plans for these amounts to be used in further expansion through projects, it did not appear in the records as was properly indicated in 1948 when such amounts were reserved. Thus, while in 1948 it was already clear that the money was intended for future projects, in 1953 upon reversion to the general fund, no such intention was shown . . . Persuasive jurisprudence on the matter such as those in the United States from where our tax law was derived, has it that: 'In order to determine whether profits were accumulated for the reasonable needs of the business or to avoid the surtax upon shareholders, the controlling intention of the taxpayer is that which is manifested at the time of the accumulation, not subsequently declared intentions which are merely the products of afterthought.' (Jacob Mertens, Jr., The Law of Federal Income Taxation, Vol. 7, Cumulative Supp., p. 213.) The reversion here was made because the reserved amount was not enough for the projects intended without any intent to channel the same to some particular future projects in mind."

The taxpayer also argued that the surplus of ₱347,507.01 was not an unreasonable accumulation because its expenses of ₱560,717.44 for that year was more. The Supreme Court agreed with the Government that there was no need "to have such a large amount at the beginning of the following year because during the year, current assets are converted into cash and with the income realized from the business as the year goes, these expenses may well be taken cared of."

As to ground No. 5 of respondent, the Supreme Court stated that this "shows all the more the unreasonable accumulation. As of December 31, 1953, already ₱59,794.72 was spent — yet as of that date there was still surplus of ₱347,507.01."

Ground No. 4 was also used by the Supreme Court to support its conclusion. It said that for the year 1953 alone, ₱197,-229.26 was withdrawn by shareholders, yet as at the end of that year, there remained a surplus of ₱347,501.01. The Court believed that "these advances were in fact indirect loans to the stockholders indicating the unreasonable accumulation of surplus beyond the needs of the business."

This decision also approved the examination of periods previous to the taxable year involved. The Court stated:

> "There was no error in the process applied, for previous accumulations should be considered in determining unreasonable accumulations for the year concerned. 'In determining whether accumulations of earnings or profits in a particular year are within the reasonable needs of a corporation, it is necessary to take into account prior accumulations, since accumulations prior to the year involved may have been sufficient to cover the business needs and additional accumulations during the year involved would not reasonably be necessary.' (Jacob Mertens, Ibid, 202.)"

The question of reasonableness of accumulation decided by the Supreme Court had also been explored by the Court of Tax Appeals in two other cases decided so far by the courts. In one, *Bicol Trading, Inc. v. Commissioner of Internal Revenue,*[6] the taxpayer succeeded in showing by clear preponderance of evidence that the accumulation was well within the reasonable needs of its business. In the other, *Manila Wine Merchants, Inc. v. Commissioner of Internal Revenue,*[7] government proof that the taxpayer invested in U.S. Treasury Bonds convinced the court that to that extent, there was unreasonable accumulation. However, the lower court also found that amounts invested in affiliates and in customers' business represent proper utilization of surplus and are therefore harmless accumulations.

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[6] See note 3, *supra.*

[7] CTA Case No. 1415, February 28, 1966.

Besides the question of reasonableness of the accumulation, section 25 presents other problems. like the basis or measure of the 25% tax and minority suit for damages against the majority stockholders responsible for allowing the accumulation. The first question had already been answered by the Court of Tax Appeals in the *Manila Wine Merchants* case, when it upheld taxpayer's view that the 25% surtax is imposed "on the total surplus or net income for the year after deducting therefrom the income tax due" and not, as contended by the Government, on the total surplus available at the end of each calendar year.

In the *Basilan Estates* case, the taxpayer invoked the proviso in section 25 that the surtax did not apply to accumulations invested in dollar producing or dollar-saving industry or in the purchase of Central Banks Bonds. This was an amendment added by Rep. Act No. 1823 on June 22, 1957. The taxable year involved, however, was 1953. For this reason, the Supreme Court rejected this contention of taxpayer.

B. *Dividends received by the insurance companies*

Originally, section 24 of the Tax Code imposed a net income tax on all income of domestic corporations and on Philippine-source income of resident foreign corporations, but provided that only 25% of dividends received by them from domestic corporations was taxable. In 1957, Congress enacted Rep. Act No. 1855 adding a second paragraph to section 24 to govern the taxation of life insurance companies at 6 1/2% of their total investment income. The proviso permitting taxation of only 25% of dividends from domestic corporations was retained in the first paragraph.

In 1959, section 4, Rep. Act No. 2343 inserted a new paragraph to govern the taxation of foreign corporations, but the method of taxing life insurance companies was preserved in the last paragraph. The dividend exclusion proviso was retained in the first paragraph.

In view of these structural changes, there arose speculations in the practice that life insurance companies ceased to benefit from the dividend-exclusion proviso upon enactment of the amendment in 1957. True enough, the Bureau of Internal Revenue adopted this view and issued deficiency assessments accordingly. In the first case to be decided by the Supreme Court on this point,[8] the highest court reversed the BIR and the lower court and sustained the taxpayer's view that the intent of Congress in enacting the dividend-exclusion proviso was to relieve all corporate shareholders, including life insurance companies, from double taxation of distributed earnings. The Supreme Court held that the amendment of section 24 in 1957 did not withdraw from life insurance companies the benefit of dividend exclusion which they had therefore indisputably enjoyed along with non-life insurance companies.

In sustaining the BIR, the Court of Tax Appeals stated:

> "As a general rule of statutory construction, a proviso is deemed to apply only to the immediately preceding clause or provision. Where, as in the case at bar, there is no clear legislative intention to apply it to the subsequent clause of provision (Sec. 24(b), we are constrained to interpret the proviso as affecting only the preceding clause or provision. (See Coll. et al. v. Servando de los Angeles, et al., G.R. No. 9800, August 13, 1957). Consequently, we are of the opinion that the proviso relative to the returnability of only 25% of such dividends applies only to corporations organized in or existing under the laws of the Philippines . . . . , but not including duly registered copartnerships (*compañias colectivas*), domestic life insurance companies and foreign life insurance companies doing business in the Philippines."

The Supreme Court disapproved the foregoing analysis and reversed the lower court in this language:

> "But a purely syntactical approach is hardly a safe guide to the meaning of a statute. The position of a proviso, for instance, although pressed of considerable influence, is not necescesarily controlling. The proviso may apply to sections or portions thereof which follow it or even to the entire statute. Position, after all, cannot override intention, in the ascertainment of which the legislative history of a statute is extremely more important."

The Supreme Court then proceeded to trace the legislative history of section 24 from the enactment of the original National Internal Revenue Code in 1939 to its last amendment in 1963, and concluded in effect that the changes were so haphazard and lacking in pattern so that its grammatical construction was an unreliable guide to its meaning. Said the Court:

> "The truth is that section 24 has undergone amendments through a process which, in Cardozo's phrase (The Growth of

[8] Filipinas Life Assurance Co. v. Court of Tax Appeals, G.R. No. 21258, October 31, 1967.

the Law, 13-14 [1924]), is no more intellectual than the use of paste pot and scissors. Consequently, reliance cannot be placed on its grammatical construction in order to arrive at its meaning."

The Supreme Court also found from the legislative history that the Congress did not intend by the amendments to withdraw from life insurance companies the benefit of dividend-exclusion. On this premise, it reversed the lower court and held that "domestic and life insurance companies are entitled to the benefits of dividend exclusion, the position of the proviso notwithstanding."

C. *Unregistered partnerships*

The Tax Code provides for separate income tax treatment of registered general co-partnerships and all other kinds of partnerships, like unregistered general co-partnerships. While the former are required to file separate income tax returns, they are not taxed; the net income is taxed to the partners, whether or not the same is distributed. On the other hand, unregistered partnerships are, by definition, deemed corporations for tax purposes.[9]

It had been the practice of the BIR to go one step further in the case of unregistered partnerships by taxing also the individual partners on their distributive share of the net income, whether distributed or not. This practice was challenged by the taxpayer in the case of *J. P. Velez Coal Mines v. Commissioner of Internal Revenue.*[10] There, Velez Coal Mines are conceded to be taxable as an unregistered general partnership, but the BIR assessed deficiency individual income tax on the partner on his distributive share of net income. During the trial, the Commissioner failed to present any evidence that profits of the partnership were ever distributed or received by the alleged partners. In fact, he did not even allege this fact.

The Court of Tax Appeals reversed the Commissioner of Internal Revenue, there being no proof that the partnership profits were distributed. Since the partnership was not registered, it was taxable as a corporation, and it becomes material to determine whether or not the partner received his distributive share of the profits.

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[9] Tax Code, Secs. 24, 26 & 84.
[10] CTA Case No. 1185, February 27, 1967.

Unfortunately, the Government did not appeal this decision, and it might take some more time before a similar case will arise for decision by the Supreme Court. In the meantime, the rule in the J. P. Velez case is the law on the matter. Since it is a case of first impression in this jurisdiction, it is included in this survey, although decided by a lower court.

D. *Deductions.*

Among the questions most often litigated in income taxation are those concerning deductions from gross income. 1967 had its usual share of these cases, by and large following the well-trodden paths of earlier decisions.

1. Salaries and bonuses

Section 30(a) of the Tax Code, allows the deduction by an employer of business expenses, "including a reasonable allowance for salaries or other compensation for personal services actually rendered..." The rule in applying this provision was stated in an early case, *Alhambra Cigar & Cigarette Manufacturing Co. v. Collector of Internal Revenue,*[11] as follows:

> "In the light of the tenor of the foregoing provision, whenever a controversy arises on the deductibility, for purposes 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 affirmative case, what is the 'reasonable allowance' therefore?"

In 1967, the Supreme Court decided an identical case involving the same parties, the same deductions but for a later period and the same recipient officers as the above-mentioned case. This was the case of *Alhambra Cigar & Cigarette Mfg. Co. v. Commissioner of Internal Revenue.*[12] As is to be expected, this later case was decided primarily on the authority and principles enunciated in the earlier case.

In the 1967 case, as in the earlier case, the taxpayer corporation paid to its President and Vice President, Messrs. Kuenzle and Streiff, salaries, bonuses, commissions and director's fees. Both these principal officers were non-residents in the Philippines. They were also controlling stockholders of the taxpayer. They visited here once every two years, staying 5 to 8

[11] G.R. No. 12026, May 29, 1959.
[12] G.R. No. 23226, November 28, 1967.

weeks. For each of the tax years involved in the 1967 case, that is, 1954 through 1957, the corporation paid to each of these officers ₱15,000 in salaries, ₱14,750 in bonuses, over ₱13,000 to ₱14,000 as commissions to managers, and an average of about ₱10,000 as director's fees. Respondent Commissioner of Internal Revenue deducted only ₱6,000 a year as reasonable salary and the amount of ₱5,850, ₱7,000, ₱5,500 and ₱6,500 respectively from 1954 to 1957 as reasonable bonus for each of the two officers. He disallowed the entire amounts deducted as commissions and director's fees. The Court of Tax Appeals sustained these disallowances, citing the earlier Supreme Court case[13] in reducing the amounts deducted as salaries and bonuses. In approving the disallowance of the entire amounts paid by the corporation as commissions to managers and director's fees, the lower court stated:

> ". . . . There is no evidence of a particular service rendered by (these officers) to petitioner to warrant payment of commissions . . . . the services mentioned (by counsel of petitioner) have been more than adequately compensated in the form of salaries and bonuses . . . We cannot see any justification for payment of director's fees of about ₱10,000 for each of said officers for coming to the Philippines to visit their corporation once in two years. Being non-residents, the resident and Vice-President of petitioner corporation of which they are the controlling stockholders, we are more inclined to believe that said commissioners and director's fees, payment of which was based on a certain percentage of the annual profits, are in the nature of dividend distributions."

The Supreme Court observed that the disallowances were carefully considered by the lower court and that the burden of the petitioner to show that the lower court erred "was far from easy". In fact the Supreme Court concluded that the taxpayer-petitioner failed in its effort and that the lower court has again correctly applied and construed section 30(a), as it did in the earlier case affirmed by the Supreme Court.[14] The Supreme Court also took advantage of the chance to reiterate the familiar rule that findings of fact made by the lower court are not disturbed by the Supreme Court, if supported by the evidence. In the precise language of Justice Fernando, the Supreme Court stated in this regard:

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[13] See note 11, *supra*.
[14] *Id.*

". . . That the questions thus involved is inherently factual, appears to be undeniable. This Court is bound by the findings of facts of the Court of Tax Appeals, especially so, where as here, the evidence in support thereof is more than substantial, only questions of law thus being left open to it for determination. (Numerous cases cited.) Without ignoring the various factors which petitioner-appellant would have this Court consider in passing upon the determination made by the Court of Tax Appeals but with full recognition of the fact that the two officials were non-residents, it cannot be said that it committed the alleged errors, calling for the interposition of the corrective authority of this Court. Nor as a matter of principle is it advisable for this Court to set aside the conclusion reached by an agency such as the Court of Tax Appeals which is, by the very nature of its function, dedicated exclusively to the study and consideration of tax problems and has necessarily developed an expertise on the subject, unless as did not happen here, there has been an abuse or improvident exercise of its authority."

2. Representation expenses

Another business expense allowed as a deduction from gross income are representation expenses. This is governed by section 30(a), Tax Code, as follows:

"(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, . . . "

which is broad enough to include what is generally known in the business world as "representation expenses". The problem faced most often by the taxpayer is one of substantiation that (1) the expense has been actually incurred, and if so, (2) its connection to the business or trade engaged in or pursued by the taxpayer. Proof under the first necessarily includes the requirement that the expense was paid or incurred within the taxable year. Proof under the second meets the requirement that the expense is ordinary and necessary and is incurred in carrying on the trade or business. These are the conditions for allowance of representation expenses as deductions from gross income.[15] Absence of invoices, receipts or vouchers, particularly lack of proof of the items constituting the expense is fatal to the allowance of

[15] Visayan Cebu Terminal Co. v. Collector of Internal Revenue, G.R. No. 12798, May 30, 1960; Collector of Internal Revenue v. Phil. Education Co., 99 Phil. 319 (1956).

the deduction.[16] The well-known relief known in taxation as the Cohan Rule will apply only if taxpayer has successfully shown that it is usual and necessary in the trade to entertain and to incur similar kinds of expenditures, there being evidence to show the amounts spent and the persons entertained, though not itemized. In such a situation, deduction of a portion of the expenses incurred might be allowed even if there is want of receipts and vouchers.[17]

In the case of *Collector of Internal Revenue v. Goodrich Int. Rubber Co.*[18] the Supreme Court specified the kind of receipts acceptable as proof. In that case, taxpayer corporation deducted the sum of ₱30,138.88 as representation expenses. The only proof presented were receipts signed by the different officers of the company who received the amounts. No receipts signed by the entities to whom these amounts were allegedly paid were presented. Thus, although it was claimed that these sums represented payments to the Elks Club, Manila Polo Club, Army and Navy Club, Manila Golf Club, Wack Wack Golf Club or the Casino Español, none of the receipts issued by these entities were presented. In sustaining the disallowance made by the lower court, the Supreme Court held that representation expenses incurred by company officers must be supported by receipts or chits of the entities to whom paid in order to be deductible. Receipts signed by the company officers themselves are not sufficient, for while they may show that they received the amounts from the company, they do not prove payment of the alleged representation expense to the entity in which the same is incurred or that they were incurred.

Production of the receipt issued by the entity to which the amount deducted is paid is an effective measure to prove that the expense was actually incurred. It is not unduly difficult to comply with. Moreover, issuance of the receipt is a useful aid to the Bureau of Internal Revenue in policing the area of accurate reporting of receipts by business and service entities.

The lack of supporting vouchers, receipts and other documentary proof, however, may be excused under section 337, Tax Code. This provision requires the preservation of books of ac-

[16] Gancayco v. Collector of Internal Revenue, G.R. No. 13325, April 20, 1961, 59 O.G. 4837 (Aug., 1953).
[17] *Id.*
[18] G.R. No. 22265, December 22, 1967.

counts and other accounting records for a period of five (5) years from date of last entry in each book, during which period they are available to examination and inspection by officers of the Bureau of Internal Revenue.

In the case of *Basilan Estates, Inc. v. Commissioner of Internal Revenue,*[19] taxpayer-company deducted "miscellaneous expenses" and "officer's travelling expenses" under section 30(a). The same were disallowed by the Commissioner of Internal Revenue for lack of supporting papers or satisfactory explanation. The company accountant testified that the expenses represented actual expenses and fare of the president incurred in the interest of the company in trips from Basilan to Manila. He also testified that there were vouchers and receipts supporting the expenses but these were burned in a fire that occured in Basilan on March 30, 1960. Asked to explain why the papers supporting the expenses were not sent to the BIR in Manila on Feb. 9, 1959, before the fire, when the BIR decided to investigate, the witness stated that on that date, taxpayer had no more legal obligation to keep the same for over five years had elapsed from the time they were incurred. On this ground, both the Tax Court and the Supreme Court sustained the taxpayer under section 337, Tax Code, and allowed the deduction. Where the BIR investigation, however, occurs within five years from the date provided in section 337, Tax Code, lack of receipts supporting alleged business expenses cannot be excused.[20]

3. Loss deduction-mortgage security

Section 30(c), of the Tax Code, allows corporations to deduct losses as follows:

> "(2) BY CORPORATIONS. — In the case of a corporation, all losses actually sustained and charged off within the taxable year and not compensated for by insurance or otherwise."

The requirements of this deduction were pointed out by the Supreme Court in the case of *Plaridel Surety & Insurance Co. v. Commissioner of Internal Revenue.*[21] Petitioner is a domestic corporation engaged in the bonding business. By a contract executed on Nov. 9, 1950, it executed a performance bond, with itself as surety and solidarily with one, Constancio San Jose as principal, in favor of a machinery company, to secure the per-

[19] See note 5, *supra.*
[20] Tan Guan v. Court of Appeals, G.R. No. 23676, April 27, 1967.
[21] G.R. No. 21520, December 11, 1967.

formance of the contractual obligations of San Jose. To secure itself against loss, petitioner in turn required San Jose and another individual, to execute chattel and real estate mortgages on certain machineries and real estate. San Jose failed to perform its contractual obligation and petitioner was required to make good on its performance bond, pursuant to a suit brought against San Jose and petitioner. In the same suit, the Court of First Instance required San Jose and the other individual to reimburse petitioner for whatever amount it paid to the plaintiff obligee. Said decision was affirmed by the Court of Appeals and the Supreme Court.[22] The decision having become final in 1957, petitioner herein paid in that year the total sum of ₱44,490. In its income tax return for that year, petitioner deducted as loss said sum of ₱44,490.

Respondent Commissioner of Internal Revenue disallowed the deduction and issued a deficiency income tax assessment. This disallowance was appealed to the Tax Court which dismissed it on the ground that the same was "compensated for otherwise than by insurance — thru the mortgages in its favor executed by San Jose and Cuervo — and it had not yet exhausted all its available remedies, especially as against Cuervo, to minimize its loss."[23]

In considering petitioner's appeal, the Supreme Court discussed the reproduced portion of section 30(d), as follows:

> "Loss is deductible only in the taxable year it actually happens or is sustained. However, if it is compensable by insurance or otherwise, deduction for the loss suffered is postponed to a subsequent year, which, to be precise, is that year in which it appears that no compensation at all can be had, or there is a remaining or net loss, i.e., no full compensation."

In the case at bar, the Supreme Court found that petitioner's loss was compensable otherwise (than by insurance) by the chattel and real estate mortgages executed in its favor by San Jose and Cuervo, especially so because petitioner obtained a final judgment against them for reimbursement of payments made. The taxpayer must exhaust its remedies first to recover or reduce its loss before it could deduct any losses. The Supreme Court observed that the evidence showed that petitioner had not

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22 Plaridel Surety & Insurance Co. v. P.L. Galang Machinery Co., 100 Phil. 679 (1957).
23 *Id.*

exhausted its remedies, and on this ground affirmed the disallowance of the deduction.

The petitioner insisted that although its loss was compensable "otherwise" (than by insurance), there was remote possibility of recovering and under the *Cu Unjieng* case,[24] it should be allowed to deduct without exhausting its remedies. The Supreme Court distinguished the *Cu Unjieng,* case as not applicable for in that case, taxpayer had no legal right to compensation either by insurance or otherwise. In the instant case, petitioner had a legal right to be compensated.

The Supreme Court, in the process, also pointed out to another requirement of section 30(d)(2) not present in the U.S. Internal Revenue Code of 1939 — that is, the loss, to be deductible, must be charged off by the corporation.

In the instant case, petitioner failed to prove that it charged off the amount of the loss claimed as a deduction. This further denies to it the right to deduct the loss.

This decision enriches local jurisprudence on this point. In the earlier cases of *Cu Unjieng,* and *Hilado v. Collector of Internal Revenue,*[25] the Supreme Court denied the benefit of section 30(d)(2) because the corporate taxpayers failed to deduct alleged losses in the year when they were actually suffered in 1945 (during the liberation of the Philippines by U.S. forces). Taxpayers invoked the theory that their losses were compensated for by (insurance) "or otherwise" because of public promises announced by the President of the United States and other leaders that the United States will compensate all war losses and by the subsequent passage by the United States Congress of the Philippine Rehabilitation Act of 1946[26] which effected such compensation. Hence, argued these taxpayers, their losses were not closed or determinable until after the War Damage Commission notified them that no more payments were forthcoming.

The Supreme Court, however, rejected the theory because it found that taxpayers in those cases had no legal right to be compensated for their losses. Thus, the general rule applied that the losses should have been deducted at the time they actually occurred.

[24] Cu Unjieng Sons, Inc. v. Board of Tax Appeals, 100 Phil. 1 (1956).
[25] *Supra.;* Hilado v. Collector of Internal Revenue, 100 Phil. 288 (1956).
[26] 60 Stat. 128 (1946).

Subsequently, the Supreme Court considered war losses that occurred in April, 1942, as being compensated for by "insurance or otherwise" under the War Damage Insurance Act of March 27, 1942[27] the taxpayer to deduct in its 1950 and 1951 returns losses sustained in 1942 for it was only in these later years that its losses were finally determined.[28]

4. Bad debts deduction

Bad debts, regardless of nature, are allowable deductions under section 30 (e), Tax Code, if ascertained to be worthless and charged off within the taxable year. Section 102, Income Tax Regulations, also requires that a statement showing the propriety of the bad debt deduction must be filed with the return.

It is established by jurisprudence that this deduction requires proof (1) of the existence of the debt, (2) of its ascertainment as worthless in the taxable year deducted, and (3) that it was charged off in said year. In the case of *Commissioner of Internal Revenue v. Goodrich International Rubber Co.*,[29] the Supreme Court discussed the content of the second requirement, ascertainment of worthlessness.

There, the taxpayer, in its 1951 income tax return, deducted as bad debts the accounts of some 18 debtors, ranging in amounts from ₱14 and ₱45 to ₱11,686.93 and ₱17,810.26. About 8 more debts were less than ₱1,000, and of the remaining six debts, 2 were over ₱1,000, 1 over ₱2,000, 2 over ₱3,000 and 1 over ₱4,000. Eight (8) of the debtors made subsequent payments of their accounts, 3 of them in full. Save in one, no suits to collect were filed because counsel found no sufficient leviable property of the debtors. Proof was shown that the usual demand letters of counsel and threats to sue were made and that investigations were made of debtors' ability to pay gave negative results. All the subsequent payments of debtors were returned as taxable income. The lower court was satisfied and allowed deduction of all the items.

On appeal, however, the Supreme Court modified the decision and disallowed some of the deductions made. In so modifying, the Supreme Court added the requirement that in ascertaining worthlessness, the taxpayer-creditor must act in good faith,

[27] 56 Stat. 174 (1942).
[28] Commissioner of Internal Revenue v. Asturias Sugar Central, Inc., G.R. No. 15013, August 31, 1961.
[29] See note 18, *supra*.

must show that it had reasonably investigated relevant facts and had drawn a reasonable inference from the information obtained that the debts were worthless. The Supreme Court cited the fact that some debtors made subsequent payments as showing undue haste of creditor in charging off the debts. The Court added that there was lack of proof that those debtors lacked ability to pay. Finally, the Supreme Court observed that the petitioner did not attach to its income tax return a statement showing the propriety of the alleged deduction as required by the Income Tax Regulations.

At the same time, the Supreme Court sustained the deduction of those debts where no later payments were made. The writ of execution issued against the debtor sued was returned unsatisfied for he had no property. Counsel and collectors were unsuccessful in collecting the other debts, and because they were small amounts, the Court agreed with counsel that the unsuccessful efforts were sufficient basis for ascertainment of worthlessness, without need of suing in court.

5. Depreciation deduction

Another deduction allowed by section 30, Tax Code, is depreciation, which is, under par. (f) thereof, "a reasonable allowance for deterioration of property arising out of its use or employment in the business or trade, or out of its not being used."

In the *Basilan Estates, Inc.* case,[30] the Supreme Court decided that the basis of the depreciation rate is the acquisition cost of the property and not its replacement cost. In that case, taxpayer deducted as depreciation in 1953, the sum of ₱47,342.53. The BIR examiner discovered, upon investigation, that the same asset had been depreciated in 1952 by only ₱36,842.04, a value fixed by the taxpayer itself based on the acquisition cost. The respondent therefore allowed this same amount as depreciation deduction in 1953, disallowing the excess of ₱10,500.49. On the other hand, taxpayer reappraised its asset in 1953 due to the increased replacement cost. The Supreme Court rejected taxpayer's theory on the basis of the proviso in section 30(f)(1), Tax Code, as follows:

> ". . . *Provided,* That when the allowance authorized under this subsection shall equal the capital invested by the taxpayer . . . no further allowance shall be made."

[30] See note 5, *supra.*

Thus the Supreme Court reasoned that the law

> . . . "allows a deduction from gross income for depreciation *but* limits the recovery to the capital invested in the assets being depreciated.
>
> "The income tax law does not authorize the depreciation of an asset beyond its acquisition cost. Hence, a deduction over and above such cost cannot be claimed and allowed. The reason is that deductions from gross income are privileges (Palmers v. State Comm. of Revenue & Taxation, 156 Kan. 690, 135 P2d 899), and not matters of right (Southern Weaving Co. v. Query, 206 SC 307, 34 SE 2d 51). They are not created by implication but upon clear expression in the law."[31]

Deduction in excess of the invested capital violates the underlying purpose of the depreciation allowance. Said the Court in this regard:

> "Moreover, the recovery, free of income tax, of an amount more than the invested capital in an asset will transgress the underlying purpose of a depreciation allowance. For then what the taxpayer would recover will be, not only the acquisition cost, but also some profit. Recovery in due time thru depreciation of investment made is the philosophy behind depreciaion allowance; the idea of profit on the investment made has never been the underlying reason for the allowance of a deduction for depreciation."

II. SALES AND COMPENSATING TAXES

A. *Original sale*

The Tax Code, under sections 184-186, imposes a tax on original sales made by a manufacturer or producer measured by the gross selling price or gross value in money of the article sold. For a while, there had been a problem on the application of these articles as respects sales of forest products by the forest concessionaire, caused by the confusion on the true nature of forest charges paid by these concessionaires. (This aspect is discussed more fully *infra,* under forest charges.)

From the beginning, it seemed settled that forest concessionaires selling their logs and other forest products to sawmills and other lumber dealers were subject to the sales tax imposed under section 186. This was the period when forest charges had been accepted as internal revenue taxes, and was true as late as April, 1960 when the Supreme Court promulgated its decision in

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[31] See Gutierrez v. Collector of Internal Revenue, G.R. No. 19537, May 30, 1965.

Lacson v. Collector of Internal Revenue,[32] Then on May 31, 1960, the highest Court, in the case of *Collector of Internal Revenue v. Pio Barretto Sons, Inc.,*[33] disagreed with the lower court on the nature of forest charges and held the same not to be internal revenue taxes, but payment for timber taken from public forest. Said the Supreme Court:

> Moreover, as already stated in the decision, forest charges and surcharges are payments for timber taken from public forests, and they are considered as internal revenue taxes only in the sense that they are collected by the Collector of Internal Revenue and the regulations for their collection are contained in the National Internal Revenue Code. Forest products are obtained under licenses issued by the Government and forest charges are in a sense contractual in origin."

Pursuing the logic of the Barretto decision to its extreme some forest concessionaires believed that their sales of logs and other forest products to sawmills and lumber dealers are not original sales and therefore not taxable for sales tax purposes. Rather, the original sale is made to them by the Government when they pay the forest charges. Surprisingly, this stand was upheld by the Court of Tax Appeals in *Guerrero v. Collector of Internal Revenue,*[34] which reversed the assessment of ₱1,192.51 issued against taxpayer as deficiency for sales taxes on logs the taxpayer-concessionaire sold to a lumber company. Said the Court of Tax Appeals:

> "If forest products are sold by the Government to whoever cuts and removes the same from the forests, it follows that the original sale is made by the Government, and the cutter who sells such forest products cannot be held subject to the percentage tax imposed by section 186 of the Revenue Code on his sale of such forest products because it is not the original sale within the meaning of said section (See Op. Sec. of Justice, Nov. 14, 1946; People v. Pastor, 77 Phil. 1001.) . . . . . ."

Taking strong exception to this decision, the government appealed to the Supreme Court in *Commissioner of Internal Revenue v. Guerrero.*[35] (On the other hand, taxpayer appealed that portion of the decision holding him liable for unpaid forest charges on the logs he sold to the lumber company in *Guerrero v. Commissioner of Internal Revenue.*[36]) The Supreme Court clarified the whole matter and held that forest charges are internal

[32] G.R. No. 12945, April 29, 1960, 58 O.G. 889 (June, 1962).
[33] G.R. No. 11805, May 31, 1960, 58 O.G. 4952 (July, 1962).
[34] CTA Case No. 285, August 31, 1961.
[35] G.R. No. 19074, January 31, 1967.
[36] G.R. No. 19089, January 31, 1967.

revenue taxes, not in the technical sense of "taxes" but under its broad meaning in the General Administrative Provisions of the Tax Code, Title IX. It mentioned that in the Barretto case,[37] it held:

> "that the Government does not sell forest products, but merely collects charge on the privilege granted by it 'for the exploitation of forest concessions, i. e., charges for the right to exercise the privilege of cutting timber from a public forest or reserve'. In line with this view, we stressed in Cordero v. Gonda, L-22369 (Oct. 15, 1966), the declaration that a forest charge 'is a tax not on the minerals, but upon the privilege of severing or extracting the same from the earth,' although strictly a fee for something received is not a tax."

The Supreme Court therefore concluded:

> "As a consequence, the original sale, as contemplated in Sec. 186 of the Internal Revenue Code, is made by the concessionaire or whoever cuts or removes forest products from public forests or forest reserves . . ."

In effect, the Supreme Court seemed to be saying that the forest charges paid by the concessionaire to the government is a tax on the privilege of cutting forest products and not the price (for buying them from the government). Hence, there is no sale at all of forest products from the government to the concessionaire. The original sale, therefore, is that proceeding from the concessionaire to his customers. It is that sale which is subject to the sales tax under section 186, Tax Code.

This holding finally sets at rest the question of what is the original sale as respects forest concessionaires selling forest products to sawmills and lumber dealers, in the same way that the decision, as will be shown *infra,* finally settles that forest charges are internal revenue taxes collectible as liens from whomever is in possession thereof "unless he can show that he has the required auxiliary and official invoice and the discharge permit."[38]

B. *Exemption.*

One question that should interest the reader is exemption from the sales tax. During the year under review, the Supreme Court passed upon three facts of this problem.

1. Only the taxpayer can be exempt

One element in analyzing tax statutes is the question of who is the taxpayer. On the answer depends not only who is

[37] See note 33, *supra.*
[38] See note 36, *supra.*

the person liable to pay the tax but, in those cases where exemptions are granted, who are the persons exempt from its payment. In its decision in the case of *Philippine Acetylene Co., Inc. v. Commissioner of Internal Revenue,*[39] the Supreme Court decided in effect that only those directly charged with a tax can be exempt therefrom.

In that case, petitioner, a manufacturer of gases, sold its products to the National Power Corporation and Voice of America, both exempt agencies of the Philippine Government and of the United States. Respondent Commissioner of Internal Revenue assessed petitioner for deficiency sales tax on said sales for petitioner excluded them in computing his sales tax due during the period covered, June 30, 1953 to June 30, 1958. Petitioner based its exclusion on the theory that these customers are exempt from the sales tax by express provision of Rep. Act No. 987, amending Rep. Act No. 358, in the case of the National Power Corp., and by express agreement between the Government of the Philippines and the United States, in the case of Voice of America.

The Supreme Court held that sales to these customers, their exempt status notwithstanding, are subject to the sales tax. It reached this conclusion on the premise that the sales tax is a tax on the producer, the manufacturer, and not on the purchaser, and the fact that the incidence finally settles on the purchaser is not sufficient to make it so. Then the Court pointed to the similarity between the exemption enjoyed by the NPC and that enjoyed by the Federal and State Governments of the United States with respect to the taxes imposed by either authority. The Supreme Court proceeded to trace the development of the judicial decisions of the U.S. Supreme Court, from the early decision prohibiting the collection of the state sales tax on sales of gasoline made to the Federal Government because of the doctrine of intergovernmental immunity,[40] followed in the Philippines in *Standard Oil Co. v. Posadas.*[41] The Court noted the dissenting opinions of Justices Holmes and Stone:

39 G.R. No. 19707, August 17, 1967.
40 Panhandle Oil Co. v. Mississippi, 277 U.S. 218, 48 S.Ct. 451, 72 L.Ed. 857 (1928)
41 55 Phil. 715 (1931).

"'If the plaintiff in error had paid the tax and added it to the price the government would have nothing to say. It could take the gasoline or leave it but it could not require the seller to abate his charge even if it had been arbitrarily increased in the hope of getting more from the government than could be got from the public at large . . . . It does not appear that the government would have refused to pay a price that included the tax if demanded, but if the government had refused it would not have exonerated the seller . . . .

"'. . . I am not aware that the President, the Members of the Congress, the Judiciary or to come nearer to the case at hand, the Coast Guard or the officials of the Veterans' Hospital (to which the sales were made), because they are instrumentalities of the government and cannot function naked and unfed, hitherto have been held entitled to have their bills for food and clothing cut down so far as their butchers and tailors have been taxed on their sales; and I had not supposed that the butchers and tailors could omit from their tax returns all receipts from the large class of customers to which I have referred. The question of interference with Government, I repeat, is one of reasonableness and degree and it seems to me that the interference in this case is too remote.'"

and cited their gradual adoption as majority opinion in the subsequent cases of *James v. Dravo Construction Co.*,[42] *Alabama v. King & Boozer*,[43] *Penn Dairies Inc. v. Milk Control Comm.*,[44] and finally in *Esso Standard Oil v. Evans*.[45] Taking its cue from the drift of the foregoing American decisions, our Supreme Court reasoned that if a claim for exemption from the sales tax based on "state immunity cannot command assent, much less can a claim resting on a statutory grant." The Court continued to state its position unequivocably and said:

"It may indeed be that the economic burden of the tax finally falls on the purchaser; when it does the tax becomes a part of the price which the purchaser must pay. It does not matter that an additional amount is billed as tax to the purchaser. The method of listing the price and the tax separately and defining taxable gross receipts as the amount received less the amount of the tax added, merely avoids payment by the seller of a tax on the amount of the tax. The effect is still the same, namely, the purchaser does not pay the tax. He pays or may pay the seller more for the goods because of the seller's obligation, but that is all and the amount added because of the tax is paid to get the goods and for nothing else.

[42] 302 U.S. 134. 58 S.Ct. 208, 82 L.Ed. 155 (1937).
[43] 314 U.S. 1, 62 S.Ct. 43, 86 L.Ed. 3 (1941).
[44] 318 U.S. 261, 63 S.Ct. 617, 87 L.Ed. 748 (1943).
[45] 345 U.S. 495, 73 S.Ct. 800, 97 L.Ed. 1174 (1953).

> "But the tax burden may not even be shifted to the purchaser at all. A decision to absorb the burden of the tax is largely a matter of economics. Then it can no longer be contended that a sales tax is a tax on the purchaser."

In addition to the foregoing rationale, the Supreme Court disposed of the question as respects Voice of America by invoking the well-known rule, underlying interpretation of exemption statutes, that exemptions from taxes are strictly construed against the taxpayer. The Court adverted to this rule because the taxpayer (and the Court of Tax Appeals) believed that exemption of sales to Voice of America rested on stronger grounds than the sales to the NPC, particularly because BIR Gen. Circular No. 141, Oct. 16, 1947, allegedly issued to implement the Agreement between the Philippine and United States governments provided:

> "Goods purchased locally by U.S. civilian agencies directly from manufacturers, producers, or importers shall be exempt from the sales tax."

The Supreme Court observed that there was nothing in the purported Agreement to justify the general exemption granted in the circular mentioned, and concluded:

> "It is a familiar learning in the American law of taxation that tax exemption must be strictly construed and that the exemption will not be held to be conferred unless the terms under which it is granted clearly and distinctly show that such was the intention of the parties. Hence, insofar as the circular of the Bureau of Internal Revenue would give the tax exemptions in the Agreement an expansive construction, it is void."

It appears that in the view of the Supreme Court, the VOA was not even entitled to exemption. The rule is now settled, therefore, that a producer or manufacturer subject to the sales tax under sections 184-186, Tax Code, must include in his taxable sales even those made to customers who are exempt.

2. Importations taxable under section 189, Tax Code

Under section 188(d), Tax Code, articles "subject to tax under section 189", Tax Code, are exempt from the tax imposed under sections 184-186. It is to be noted that a similar tax, with identical rates, is imposed under section 183, Tax Code, on Importations, and that the exemption from the sales tax mentioned in section 188 includes exemption from this tax, otherwise known as the advance sales tax.

In the case of *Comm. of Internal Revenue v. Victorias Milling Co. and C.T.A.*,[46] the Supreme Court applied the exemption under section 188(d). In that case, the sugar mill imported empty sugar bags to be used as containers for its sugar manufactured for sale. The question was whether or not the importation was subject to the advance sales tax.

The Commissioner of Internal Revenue contended that section 188(d) would not apply because section 189 imposes the tax on "sugar", not on the containers. In other words, the imported bags had not yet been subjected to any tax, and so the evil of double taxation sought to be remedied by the exemption in section 188(d) did not exist.

The Supreme Court cut through all the legal niceties advanced by the opposing contentions and presented a simplified issue: whether or not the imported bags are subject to the advance sales tax under section 183(b) in relation to section 186, both of the Tax Code. In holding that the sugar bags were not subject to the advance sales tax, the Supreme Court rejected the argument of the Commissioner mentioned above. The Court said:

> "We find the stand of the Commissioner to be untenable for it does not take into account two undeniable facts: (a) that there is no evidence to the effect that the containers or sacks are separately charged against the sugar buyers and, as a consequence, the domestic buyers of the sugar pay only one price for both sugar and container; and (b) that the buyer takes away with him the sugar and its container. On this basis, the price paid by the customer either includes both the price of the sugar and that of the container, or else it represents the price of the sugar alone. If it be the first (the price is paid for both sugar and sack), then the value of the sacks is already subjected to the 2% tax imposed by section 189, and the sugar company has paid the same; hence, it may no longer be separately taxed (Section 188(d), Tax Code).
>
> "If, on the other hand, the price paid by the buyer is for the sugar alone, then obviously the container is merely given away *gratis* and *not sold*. In which case, there is no sale of the container that can be subjected to the percentage sales tax."

3. Reparations

Another aspect of the exemption from compensating tax decided during the year being reviewed pertains to reparations

[46] G.R. No. 21171, January 31, 1967.

vessels purchased under the reparations law. The Supreme Court discussed this matter in the case of *Commissioner of Internal Revenue v. Botelho Shipping Corp. and General Shipping Co., Inc.*[47]

Under section 14, Rep. Act No. 1789, the original Reparations Act, buyers of reparations goods from the Reparations Commission acquired from Japan under the Philippine-Japan Reparations Agreement of May 9, 1956, were expressly exempted from payment of customs duties, consular fees and special import tax. On August 30 and Sept. 19, 1960, two shipping companies, the respondents in the case, bought two (2) vessels from the Reparations Commission under the Reparations Act payable in installments over 10 years. Upon arrival in Manila, the government, through the petitioners herein, refused to release the vessels unless compensating tax was paid on each of them. The buyers contested this refusal on the ground that the Reparations Commission, under the contract of sale, still owned the vessels until payment of the price was completed. They simultaneously filed a petition in the Court of Tax Appeals and a motion for suspension of the collection of the compensating tax. The motion was granted upon filing of a bond by each buyer.

Pending the decision, Rep. Act No. 3079 was passed and made effective on June 17, 1961, amending Rep. Act No. 1789. The amendment, so far as relevant to the pending case, expressly added "compensating tax" in section 14 as among the taxes and fees from which reparations buyers and end-users are exempt. Section 20 of the amendment also provided that end-users may apply for the renovation of their utilization contracts in order to avail of any provision of Rep. Act No. 3079 favorable to them if they voluntarily assume any new obligations provided thereunder.

The buyers, respondents in the instant case, accordingly applied for renovation of their purchase agreement. The Reparations Commission approved such renovation. Hence, the buyers amended their petition in the Tax Court.

The issue raised was whether or not the benefits of Rep. Act No. 3079 exempting reparations buyers from the compensating tax applied to persons who bought vessels before the amendment. The lower court decided in favor of the buyers.

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[47] G.R. No. 21633, June 29, 1967.

In affirming, the Supreme Court pointed out the fallacy of the government view that in passing the amendment, Congress could not have intended any retroactive exemption for that would be prejudicial to the revenue. Said the Supreme Court:

> "The inherent weakness of the last ground becomes manifest when we consider that, if true, there could be no tax exemption of any kind whatsoever, even if Congress should wish to create one, because every such exemption implies a waiver of the right to collect what otherwise would be due to the Government, and, in this sense, is prejudicial thereto. In fact, however, tax exemptions may and do exist, such as the one prescribed in Section 14 of R.A. No. 1789, as amended by R.A. No. 3079, which, by the way, is 'clear and explicit,' thus, meeting the first ground of appellant's contention. It may not be amiss to add that no tax exemption — like any other legal exemption — is given without any reason therefor. In much the same way as other statutory commands, its avowed purpose is some public benefit or interest, which the law-making body considers sufficient to offset the monetary loss entailed in the grant of the exemption. Indeed, Sec. 20 of R.A. 3079 exacts a valuable consideration for the retroactivity of its favorable provision, namely, the voluntary assumption by the end-user who bought reparations goods prior to June 17, 1961, of 'all the new obligations provided for' in said Act."

The Supreme Court also disposed of the other objections raised by the Government. Thus, against the contention that the exemption would benefit particular persons, the Supreme Court replied "that there is no constitutional injunction against granting tax exemptions to particular persons... What the fundamental law forbids is the denial of equal protection, such as through unreasonable discrimination or classification." Then the Court pointed out that section 14, Rep. Act No. 1789, as amended, "exempts from the compensating tax, not particular persons, but persons belonging to a particular class", and indeed the Government did not assail the exemption granted by section 14 to end-users who bought after enactment of Rep. Act No. 3079. The Court noted that there is no difference, constitutionally, between exemption of end-users who bought after Rep. Act No. 3079 and those who bought earlier.

While this decision relates to vessels purchased from the Reparations Commission, Congress enacted a later law, Rep. Act No. 3176, June 17, 1961, exempting from the compensating tax passenger or cargo vessels purchased abroad, together with engines and spare parts. It seems that Rep. Act No. 3176 is broad enough to include vessels purchased from entities other than the Reparations Commission.

III. MINING, FRANCHISE AND OTHER TAXES

A. *Mining tax — basis or measure of tax*

In its decision in the case of *Cebu Portland Cement Company v. Commissioner of Internal Revenue,*[48] the Supreme Court ruled that the basis of the mining tax on cement is not the selling price of cement as contended by the Bureau of Internal Revenue, but the actual market value of the quarried minerals out of which the cement was manufactured. Not satisfied, the respondent Commissioner of Internal Revenue asked for reconsideration, on the ground that cement comes under the definition of "mineral product" given in section 246, Tax Code, and is therefore subject to the 1 1/2% ad valorem tax based on its selling price, and in the alternative, that the sales of cement are subject to the 7% sales tax.

In its resolution dated December 29, 1967, the Supreme Court denied both grounds, for, in the language of the Court, the "appellant Commissioner of Internal Revenue has plainly misconstrued the language and import of our main decision. We there stated the issue to be as follows:

> 'Herein petitioner contends that the collectible ad valorem tax should be based on the actual market value of the quarried minerals that were used in the production of cement; whereas, respondent Commissioner of Internal Revenue maintains that, as the cement produced by petitioner consists of minerals, the same is a mineral product pursuant to the definition given in section 246 of the Tax Code and the ad valorem tax should be based on its selling price.'

And we sustained the position of the cement company. The Supreme Court pointed out in its resolution

> "that the law intended to impose the ad valorem tax upon the market value of the component mineral products in their *original state before processing* into cement. For it cannot be overlooked that the law does not impose a tax on cement *qua cement,* but on mineral products, at least 80% of which must be minerals extracted by the lessee, concessionaire, or owner of the mineral lands. Both parties concede that cement is made up of 80% or more of minerals thus extracted."

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[48] G.R. No. 18649, February 27, 1965.

The Court continued to state that "while cement is a mineral product, it is no longer in the state or condition contemplated by law; hence the market value of the cement could not be the basis for computing the *ad valorem* tax, since the *ad valorem* tax is a severance tax, i.e., a charge upon the privilege of severing or extracting minerals from the earth and is due *upon removal* of the mineral product from its bed or mine. So that the tax is to be computed on the basis of the market value of the mineral in its condition at the time of such removal and before its being substantially changed by chemical or manufacturing (as distinguished from purely physical) processing."

In denying the alternative ground in the motion for reconsideration, the Supreme Court stated that it "did not, and could not, rule that cement is a manufactured product subject to sales tax, for the reason that such liability had never been litigated by the parties."

The rule enunciated therefore is that although a processed product falls within the definition of "mineral product" because it is composed of more than 80% minerals, the basis of the *ad valorem* tax is not its selling price in the market but the actual value of the quarried minerals composing it. It would seem from the decision that the Court considers products composed of more than 80% quarried minerals to be "minerals products" as defined in section 246, Tax Code. If this observation is correct, then cement and similar products composed of more than 80% minerals would fall under the exemption from sales tax provided in section 188(c), Tax Code, if sold by the owner or concessionaire of the land from which the quarried minerals are removed.

B. *Independent contractor*

The case decided on this topic by the Supreme Court during the year in review involved determination of whether or not, from the facts proved, taxpayers were independent contractors or were employees. The case of *Balbas v. Domingo,*[49] concerned recruiters of Ilocano laborers to cut sugar cane of the Canlubang Sugar Estate. Under the provisions of the harvest contract, the recruiters were paid at rates fixed per ton of cane harvested, from which the laborers recruited were to be paid. Canlubang

[49] G.R. No. 19804, October 23, 1967.

furnished tools, implements and other equipment for cane harvest but any damages thereto were paid for by the petitioners-recruiters, who were made responsible for the care of said tools. Recruiters also supplied their own loading boards and were required to pay in full all advances received from Canlubang. They were also bound to pay damages to Canlubang caused by violations of cutting rules, regulations and instructions. All these circumstances, according to the Court, indubitably established that the recruiters were independent contractors, not, as they alleged, employees of Canlubang. While the Court also considered the fact that cutting was done according to rules, regulations and instructions of Canlubang and under the supervision of Canlubang employees, these did not militate against the status of the recruiters as independent contractors. Even the fact that medical services were rendered by Canlubang physicians in its hospital was not sufficient to detract from the finding of the court that recruiters were independent contractors, subject to the fixed and percentage taxes being collected by respondent.

This case merely adds to the illustrative acts now recorded in the cases that make a taxpayer liable as an independent contractor. These cases invariably involve (1) the issue raised in the cited case, or (2) the issue of whether the taxpayer is an independent contractor or a manufacturer.

C. *Increased franchise tax — non-impairment clause*

In a long succession of cases, the Supreme Court has set the rule that section 259, Tax Code, fixing the franchise tax at 5% of gross receipts, does not violate the non-impairment clause[50] even if said rate is higher than that fixed in franchise granted under Act 667, for the state has reserved in said Act its power to alter, modify or repeal any franchise given pursuant thereto. And when the Congress enacted Rep. Act No. 39, which is section 259, Tax Code, it was merely exercising a power reserved to it in Act 667.[51] In the year 1967, the Supreme Court decided two more cases reiterating the doctrine pronounced in these earlier

[50] Const. art. III, sec. 1, par. (10).

[51] Hidalgo v. David, G.R. No. 8046, August 30, 1956; Hoa Hin Co., Inc. v. Blaquera, G.R. No. 11783, May 25, 1959, 56 O.G. 7298 (Nov., 1960); Lealda Electric Co. v. Commissioner of Internal Revenue, G.R. No. 16428, April 30, 1963, 62 O.G. 3367 (May, 1966); Balanga Power Plant Co. v. Commissioner of Internal Revenue, G.R. No. 20499, June 30, 1965.

decision. One, the *Imus Electric Co., Inc. v.Court of Tax Appeals,*[52] involved a contested assessment. The other, *Guagua Electric Light Plant Co., Inc. v. Coll. of Internal Revenue,*[53] sought refund of franchise taxes paid at the higher rate of 5%. In both, taxpayers invoked the non-impairment clause of the Constitution, in answer to which, the Supreme Court reaffirmed its holding in the cases enumerated above.

IV. ASSESSMENT AND COLLECTION OF TAX

The powers of the Commissioner of Internal Revenue to assess taxes and collect them by the summary means provided in the Tax Code or judicially in the courts of first instance form the justification of the existence of his Office and the essence of its function. Understandably, the Tax Code has buttressed these powers with sufficient supports to make them effective. One is the presumption of correctness enjoyed by his assessments, a doctrine scattered over most of the decisions in tax cases. This presumption relieves the Commissioner of the heavy and often times embarrassing burden of proof.

Another is the power of the officers and designated employees of the Bureau of Internal Revenue to examine the books of a taxpayer and inspect the premises of a business. To enforce assessments, the Commissioner is given summary powers to collect the tax. Liens are created over the taxpayer's property or business to ensure collection. To discourage delinquency, the Tax Code provides for interest, surcharges and penalties for late payment. Violations of the Tax Code are punishable offenses.

The Tax Code lays a heavy hand on fraudulent schemes to evade the tax. Additionally, the BIR is given a longer period to assess and collect a tax than the taxpayer's right to ask for refund. While the Commissioner has at least five years to assess and another five years to collect, the taxpayer has only two years to claim for refund and only thirty days to contest assessments administratively, and a like period to go to the Tax Court. Once these periods lapse, he is generally deprived of any defenses against suits to collect.

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[52] G.R. No. 22431, March 18, 1967.
[53] G.R. No. 23611, April 24, 1967.

Thus, each year, a great portion of cases involve taxpayer's efforts to challenge or at least mitigate the weight of these powers. The year in review has its share of these cases.

A. *Exercise of power of assessment — prescription*

1. False or fraudulent returns

In the case of *Tan Guan v. Court of Tax Appeals and Commissioner of Internal Revenue,*[54] the Commissioner assessed deficiency income tax against petitioner, a partner in a registered general co-partnership. The Commissioner disallowed three (3) items of expense deductions taken in the partnership return for 1948 because of lack of supporting receipts. Moreover, in the entries of these expenses, the names of the payees were erased; lastly, the alleged payees did not report these amounts in their returns. On these findings, the Commissioner treated the partnership income tax return as fraudulent or false with intent to evade the income tax. The deficiency income tax assessment was issued against petitioner-partner only on June 8, 1960.

In his appeal to the Tax Court, taxpayer contended that the right of the Commissioner to assess had prescribed, more than five years having elapsed after filing of the 1948 return.[55]

The Supreme Court rejected this contention, holding that the applicable period was ten years from discovery of fraud under section 332, Tax Code, for the return was false and fraudulent with intent to evade taxes. The Supreme Court affirmed the finding of the lower court that the Commissioner adequately proved this fact, not rebutted even by the taxpayer.

Taxpayer also asked that he should be given the same treatment as his partner, who did not receive any deficiency income tax assessment. The Supreme Court rejected this contention by stating that the Government was not bound by the errors committed by its agents in previous assessments and investigations.[56]

2. Non-filing of return — acquittal from criminal suit

The case of *Republic v. Patanao,*[57] presents a novel issue in the assessment and collection of taxes. Taxpayer was originally

[54] See note 20, *supra*.
[55] Tax Code, sec. 331.
[56] Phil.-American Drug Co. v. Collector of Internal Revenue, G.R. No. 13032, August 31, 1959, 57 O.G. 3915 (May, 1961).
[57] G.R. No. 22356, July 21, 1967.

criminally sued by the Government for non-filing of his income tax returns in 1951, 1952 and 1955 and for nonpayment of the income tax for 1953 and 1954. He was acquitted of these charges.

On February 14, 1958, the Commissioner of Internal Revenue issued deficiency income tax and additional residence tax assessment demanding payment of the sum of ₱79,892.75. For refusal of taxpayer to pay, the Republic of the Philippines filed a suit in the Court of First Instance to collect. Taxpayer defended by invoking acquittal from the criminal charges against him. The CFI dismissed the collection of deficiency taxes for 1951, 1952 and 1954 (income tax) and for 1951 and 1952 (residence tax) but required an answer with respect to the 1955 deficiency income tax and 1953-1955 residence taxes. The lower court premised its order on the penal law principle that acquittal exempts the accused from both the criminal and civil responsibility, there being no waiver or reservation of the right to file separate civil action. The Bureau of Internal Revenue appealed this order and the Supreme Court set it aside as erroneous. The rule applied by the lower court is correct with respect to cases falling under the Penal Code where the civil liability arises out of the offender's criminal act. The Supreme Court observed that the situation is different in tax cases, where the civil obligation to pay the tax arises not from an offense but from engaging in business, and the failure to pay the tax gives rise to the criminal offense. The Supreme Court continued:

> ". . . The incongruity of the factual premises and foundation principles of the two cases (criminal offenses and suits to collect tax) is one of the reasons for not imposing civil indemnity on the criminal infractor of the income tax law. Another reason, of course, is found in the fact that while section 73 of the National Internal Revenue Code has provided the imposition of the penalty of imprisonment or fine, or both, for refusal or neglect to pay income tax or to make a return thereof, it failed to provide the collection of said tax in criminal proceeding. . . . . Considering that the Government cannot seek satisfaction of the taxpayer's civil liability in a criminal proceeding under the tax law or, otherwise stated, since the said civil liability is not deemed included in the criminal action, acquittal of the taxpayer in the criminal proceeding does not necessarily entail exoneration from his liability to pay the taxes."

Another defense raised by the taxpayer in the cited case is prescription of the 1951 income tax deficiency for over five years had elapsed since the filing of the return. Taxpayer's counsel, however, filed a motion to dismiss the government's Complaint, which alleged, among other things, that the 1951 return was fraudulent. The Supreme Court seized upon this motion to dismiss as a hypothetical admission of the allegation of fraud, in which case, the 10 year prescriptive period of section 332, Tax Code, applied. Since the deficiency assessment was made within the ten-year-period thus provided, the right to assess had not prescribed.

3. Proof of mailing of assessment

In the case of *Basilan Estates, Inc.*[58] taxpayer filed its 1953 income tax return on March 23, 1954. On Feb. 26, 1959, the Commissioner issued deficiency income tax assessment. Taxpayer alleged that it did not receive the deficiency notice or if it did, it received the same beyond the five-year prescriptive period.

The Commissioner's evidence consisted of the office copy of the notice, on which was stamped "Feb. 26, 1959" and letters to the taxpayer asserting that the assessment notice was sent. Inter-office communications were also introduced showing that the assessment notice was sent to taxpayer. From these facts, the Supreme Court drew the presumption of official performance of duty as against contrary interpretations made by taxpayer. Hence, the Court sustained as timely the right of the Commissioner to make the deficiency income tax assessment even granting that petitioner, as alleged, received it after five years.[59]

It will be seen that in all the foregoing cases where the taxpayers challenged the power of the Commissioner to assess, the Court sustained the latter. This circumstance should be borne in mind when taxpayers choose to challenge assessments issued by the Commissioner of Internal Revenue — that it is easier for the Court to uphold the assessment than to reverse it. Such a reminder should inspire a thoroughly documented challenge supported by overwhelming evidence. In the cases cited, it is noted that there was paucity of evidence from the taxpayers.

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[58] See note 5, *supra*.
[59] Collector of Internal Revenue v. Bautista, G.R. Nos. 12250 & 12259, May 27, 1959.

B. *Power to collect taxes*

As it is said that the taste of the pudding is in the eating, the effectiveness of any Commissioner of Internal Revenue, in particular, and of the tax system in general, is tested by the amount of tax pesos and centavos actually collected. In the final analysis, the most enormous amount of tax assessment means nothing unless collected, and no more than the amount actually collected. How have the courts interpreted this power? The cases in 1967 could be considered as typical of the trend followed by the courts — sympathy with the power.

1. Undisputed assessments

A taxpayer is given by Rep. Act No. 1125 the right to challenge the correctness or legality of an assessment, but only within the confines of the limits set therein. Thus, he can contest an assessment within 30 days from date of receipt. If he fails, then the assessment becomes final and executory which the Commissioner of Internal Revenue can collect summarily by distraint or levy or judicially by filing a suit to collect in the proper court. (If he contests the same, it becomes a disputed assessment, which the Commissioner must somehow decide. The taxpayer is likewise given by Rep. Act No. 1125 30 days within which to appeal an unsatisfactory decision of the Commissioner to elevate the matter to the Tax Court.)

Sometimes, the taxpayer who failed to contest an assessment, might have valid and good defenses against the right of the Commissioner to collect. Suppose the right to assess had prescribed? Suppose the tax had been previously paid?

In the case of *Republic v. Ledesma,*[60] taxpayer filed his 1951 income tax return on or before March 1, 1952, the last day for filing. On Feb. 25, 1957, Commissioner of Internal Revenue issued deficiency income tax assessment. By letter of counsel, dated May 10, 1957, taxpayer requested for reinvestigation. In his reply, the BIR Regional Director asked counsel to specify under oath the grounds of the protest, to pay 1/2 of the amount assessed, and to secure the balance with a bond. Taxpayer did not write back nor did he comply with these requirements. On July 21, 1958, the collection suit was filed in the Court of First Instance.

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60 G.R. No. 18759, February 28, 1967.

In his Answer, taxpayer denied liability, alleging that the amount on which the tax had been levied had been previously declared as income by a son-in-law and the tax thereon been paid. He also alleged prescription of the right of the Commissioner to assess.

The Supreme Court rejected the contention of prescription by observing that since the assessment was made within five years as provided by section 331, Tax Code, a suit to collect could be brought within five years from date of assessment, as provided by section 332(c), Tax Code. The suit in the instant case satisfied the period under section 332(c). The contention that section 51(d), Tax Code (before its amendment in 1959) fixed a period of only three years from due date of return within which to collect, was likewise rejected by the Supreme Court as referring only to the summary remedies of distraint and levy. Since section 51(d) did not prescribe any limitation as to judicial action to collect income tax section 331 and 332, Tax Code, applied in a suppletory character.[61]

The Supreme Court also denied to the taxpayer the right to dispute or contest the assessment. After reciting the facts showing that taxpayer failed to comply with the conditions required for reinvestigation of the case and his failure to even challenge them, the Supreme Court stated:

> "Had appellee complied with the conditions required of him by the Bureau of Internal Revenue . . . or had he even challenged the validity of these conditions, the assessment would have been a disputed one which the Collector of Internal Revenue would have had to decide, and from his decision the recourse would have been to the Court of Tax Appeals . . . As it was, appellee's failure to dispute the assessment in the manner prescribed by law has barred his right to do so in the present case."

The Supreme Court even went further and observed "that the defense of payment of the tax, allegedly made by Raul Poblador (taxpayer's son-in-law) on the 3000 piculs of sugar, is neither very material nor decisive. The question is whether or not the assessment was correct, and the same should have been taken to the Court of Tax Appeals by petition for review if appellee

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[61] Collector of Internal Revenue v. Bohol Land Transportation Co., G.R. Nos. 13099 & 13462, April 29, 1960, 58 O.G. 2407 (March, 1962); Republic v. Gamboa, G.R. No. 16504, October 27, 1961.

had wished to dispute it." The Court then added that the defense of payment, anyway, had no evidence to support it.

The principal case merely follows the rule previously set that it is only in the Tax Court where a taxpayer might dispute an assessment; failing to do so, he is deemed to have waived his defenses, making the assessment final and executory and demandable. In the collection suit, the taxpayer will not be allowed to set up defenses that will in effect reopen the case on the merits. Only such defenses as jurisdiction, collusion or fraud in the proceedings are available.[62] This rule is observed in so far as the Government objects to any and all evidence showing prescription; where it fails to object to such evidence, the same is a wavier of its right to object and the defense of prescription is considered.[63]

2. Withholding of tax at source

Among the devices to make effective the power to collect the tax is withholding it at source. This is appropriately provided in the case of a taxpayer who is a nonresident alien not doing business here or a nonresident foreign corporation, neither of which has an office or place of business here.[64] The law places upon the payor or person having control or custody of the fixed or determinable annual or periodical income of said nonresident alien individual or foreign corporation the duty to withhold the proper amount of tax and to return and pay over the same to the Government.[65] Where the payor has definite knowledge that a nonresident alien individual is engaged in business here and of the name and address of the resident agent, he is excused from the duty to withhold (Sec. 200, Income Tax Regulations). The same section of the regulations warn that in case of doubt, the payor must withhold and promptly address a query to the Commissioner of Internal Revenue.

In the case of *Commissioner of Internal Revenue v. Malayan Insurance Co., Inc.,*[66] the Supreme Court ruled on the question whether the appointment by the nonresident taxpayer of an agent to file his income tax return here was sufficient to excuse

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[62] Republic v. Del Rosario, G.R. No. 10460, March 11, 1959; Republic v. Lim Tian Teng Sons & Co., Inc., G.R. No. 21731, March 21, 1966.
[63] Republic v. Ker & Co., Ltd., G.R. No. 21609, September 29, 1966.
[64] Tax Code, secs. 53 (b)-54.
[65] Tax Code, sec. 53 (c).
[66] G.R. No. 21913, November 18, 1967.

the payor from the duty to withhold. The lower court said "yes" and decided in favor of the payor.

In that case, payor Malayan Insurance Co., Inc. was a local insurance company which had reinsurance contracts with the Orion Insurance Co., Ltd. of London, a foreign corporation not engaged in trade or business here. In 1958, payor remitted ₱64,327.36 to Orion as reinsurance premiums covering local risks. Payor, without authority from Orion, filed the 1958 income tax return for Orion and paid thereon the sum of ₱958.00. Orion, however, commissioned another, the Filipinas Compania de Seguros, to file its 1958 income tax return. Such authorization, however, expressly stated that it was not to be taken as an acceptance by Orion of any income tax liability and that Orion was reserving the right to claim for refund of the tax paid or withheld. (It will be recalled that at that time, the question of whether or not reinsurance premiums were subject to withholding tax was pending in the courts.) While the Supreme Court finally held that they were, Rep. Act No. 3825 subsequently excepted reinsurance premiums from the enumeration of taxable income made in section 24(b) and 54, Tax Code.

When payor learned that Orion appointed Filipinas as its agent to file the income tax return for 1958, payor asked for refund of the ₱958. Payor appealed to the Tax Court upon refusal of the Commissioner to make the refund. In his Answer, the Commissioner not only denied the right to claim for refund, but made a counterclaim for payment by Malayan of the balance of the income tax it failed to withhold under section 54 in relation to section 53, Tax Code. The lower court ordered the refund of ₱958 erroneously paid by payor and dismissed the counterclaim on the ground that Orion had a duly authorized representative.

In reversing the lower court, the Supreme Court stressed the duty to withhold placed upon Malayan, and upheld the view of the Commissioner that payment by Filipinas of the supposed 1958 income tax liability of Orion did not relieve payor of said duty. The Supreme Court felt that the law, section 53(b) was broad and all-embracing and the duty to withhold was compulsory under section 53(c), Tax Code. The Court justified this interpretation as follows:

> "And this has to be so, for it must be realized that the withholding provision of Section 53(b) is a device without which the Philippine Government may not be able to collect

> the proper and correct tax on income, derived from sources in the Philippines, by aliens who are outside of the taxing jurisdiction of this country. It is for this reason that the withholding provision is not being applied if the income is to be remitted to Filipino citizens, or resident aliens, or to nonresident aliens but conducting business and maintaining offices or places of business in the Philippines."

The Supreme Court made the significant statement that in the enforcement of section 53(b) against the withholding agent, the presence of a duly authorized representative here is beside the point, for the cause of action was against the withholding agent and not against the nonresident taxpayer. This has to be taken however, in the context of the facts of the case that the representative of Orion was merely authorized to file a return, that Orion was not conceding its liability to income tax and therefore it retained the right to claim for refund of any amounts withheld. The Court also pointed out that none of the amounts remitted by Malayan, the payor, to Orion ever passed the hands of the agent, Filipinas. Another fact that led the Court to sustain the Commissioner was the great disparity between the amount actually paid by the agent as tax of Orion and that which should have been withheld on the reinsurance premiums remitted. The Court reasoned that if it did not apply the withholding provisions of section 53(b), the Government would have no way of collecting any deficiency that may be found against Orion, whose return filed by Filipinas was already found by BIR examiners to be deficient. The Commissioner cannot proceed against Filipinas, because as pointed out, its authority was limited to filing the income tax return. On these considerations, the Court ruled that Malayan was answerable for the withholding tax claimed by the Government, minus the amount of ₱958 already paid for Orion, plus appropriate penalties for late payment.

An earlier case decided in May, 1967, indicated this attitude of the Supreme Court of applying the withholding provisions liberally in favor of the Government and strictly against the local withholding agent. This was the case of *Jai Alai Corp. v. Republic of the Philippines.*[67]

In that case, Jai Alai Corp. before the war, entered into management contracts with an Egyptian who was considered a

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[67] G.R. Nos. 17462 & 17472, May 29, 1967.

legal resident of the Philippines in 1940. That Egyptian acted as general manager of Jai Alai from 1940 to 1945, receiving as compensation certain percentages of receipts. During the Japanese Occupation to 1945 his residence was the concentration camp in University of Santo Tomas. In March, 1946, he left for the United States, after securing from the Philippine Government, as early as October, 1945, re-entry permit stating that his absence here would be indefinite. On March 5, 1946, he appointed Jose Razon, the other party to the case, as his attorney-in-fact to file his tax returns and to pay and compromise taxes that may be assessed during his absence. Jose Razon was also the Vice President of Jai Alai Corp. During his stay here, the Egyptian did not engage in any trade or business and did not own property except 100 shares in the Jai Alai Corp. Since he left, he never returned here.

On August 6, 1947, Jai Alai Corp. represented by Jose Razon, its Vice President and the Egyptian entered into a contract in Los Angeles. For the sum of ₱200,000, the Egyptian acknowledged full payment of his claim for percentage fees from 1946 to 1950 and any and all future claims against Jai Alai Corp.

The ₱200,000 was paid as follows:

₱40,000 on Sept. 2, 1947 by telegraphic transfer directly from Jai Alai to the Egyptian;

₱20,000 each on Nov. 7 & 20, 1947 by Jai Alai to Jose Razon, as attorney-in-fact of the Egyptian;

₱20,000 each on Dec. 17 & 24, 1947 by Vicente Madrigal & Co. to Jose Razon, as attorney-in-fact;

₱20,000 each on Feb. 11, Mar. 11, April 10 and June 2, 1948 by Madrigal & Co. to Jose Razon as attorney-in-fact.

Jose Razon remitted all the amounts to the Egyptian in the United States. It appears from the records that Jai Alai, due to financial difficulties subrogated its rights to one of the big stockholders, Senator Vicente Madrigal, who therefore paid the obligation of Jai Alai to the Egyptian.

The BIR demanded a) that Jose Razon as attorney-in-fact pay ₱73,922.62 representing income tax liability of the Egyptian for 1946, inclusive of interest to 1951; and b) that Jai Alai (and Jose Razon) solidarily pay the withholding tax on the ₱200,000 remitted to the Egyptian in 1947 and 1948, as withholding agents under the provisions of section 53(b) and (c), Tax Code. The lower court dismissed the claim against Jose Razon for payment of the ₱73,922.62 income tax liability of the nonresident alien principal. The Supreme Court found that the Government did not appeal this dismissal. (The lower court held that although Jose Razon was admittedly attorney-in-fact for filing income tax returns and for paying and compromising the taxes assessed, there was lack of proof that he bound himself to be personally liable for the tax liability of his principal or that he guaranteed its payment).

The lower court also discharged Jose Razon from liability as withholding agent but held Jai Alai Corporation liable as such on its payment of ₱80,000 to the nonresident taxpayer. It also believed that Madrigal & Co. was liable as withholding agent on its payment of ₱120,000 to the taxpayer, but since it was not made a party, the court had no jurisdiction to sentence it to pay withholding tax.

Jai Alai Corporation and the Commissioner of Internal Revenue both appealed the decision of the lower court on the question involving the withholding tax provisions.

Jai Alai relied on three defenses: *First,* the taxpayer cannot be considered as a nonresident alien not engaged in trade or business here. The Supreme Court refused to review the finding of the lower court that the Egyptian was a nonresident alien individual not engaged in trade or business here. It merely followed the well-settled rule "that findings of fact of the Court of Tax Appeals are not reviewable by Us, as long as they are supported by substantial evidence."

The *second* defense of Jai Alai was that the ₱200,000 was not payment of fixed or determinable annual or periodical income but constituted the price for the sale by the taxpayer of his inchoate or contingent interest. After citing the manner of payment made in several installments, and tracing the right of the taxpayer to be paid fees for acting as general manager, which fees were measured by certain percentages of receipts, the Court was convinced that the ₱200,000 represented "payment of *percentages or income* earned by Assadourian during the years aforesaid (1946-1950) out of the profits realized by the Jai Alai Stadium. Being so, it was taxable, and the corresponding tax should have been withheld."

The *third* defense of Jai Alai, as well as Razon, was that they did not have control, receipt, custody or disposal of the

₱200,000 remitted to the taxpayer. The Supreme Court found otherwise on the basis of the facts proved.

It found Jai Alai liable for the withholding tax on the full ₱200,000 for:

> ₱40,000 was paid directly by it to the nonresident alien taxpayer by telegraphic transfer;
>
> ₱40,000 was paid by it to Jose Razon as attorney-in-fact of the taxpayer (In fact, Jai Alai paid this sum through its Vice President, Jose Razon);
>
> ₱120,000 was paid by it through the medium of its principal and controlling stockholder, Sen. Vicente Madrigal, on the doctrine of piercing the corporate veil.

As to Jose Razon, the Supreme Court modified the lower court's decision and held him liable (his Intestate) as withholding agent for the tax on ₱160,000 paid to the nonresident alien taxpayer. The Court pegged this liability on the capacity of Jose Razon as Vice President of Jai Alai and at once attorney-in-fact of the nonresident taxpayer. In both capacities, he received and transmitted the sum of ₱160,000.

The Court held that the obligation to pay the withholding tax on ₱160,000 was joint and solidary between Jai Alai and Jose Razon and the obligation on the ₱40,000 belonged alone to Jai Alai.

With these two cases in mind, it is always the better part of prudence to follow the advice of section 200, Income Tax Regulations, that in case of doubt, the payor should withhold the appropriate tax first then direct a query to the Commissioner of Internal Revenue.

3. Execution

Ordinarily, execution belongs to the prevailing party as a matter of right at the termination of the suit for it "it is fruit and end of the suit, and is aptly called the life of the law."[68] This was interpreted by the Supreme Court in the case of *Commissioner of Internal Revenue v. Visayan Electric Co.,*[69] as permitting the execution of that portion of the judgment that

> "(1) is not the subject of appeal, (2) is separable and distinct and will not be affected by the appeal in other respects, (3) needs no further proceedings and (4) has acquired finality."

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[68] Ipekdjian Merchandising Co., Inc. v. Court of Tax Appeals, G.R. No. 14791, May 30, 1963.

[69] G.R. No. 24921, March 31, 1967.

In that case, the Government sought to collect from the taxpayer three taxes: (a) income tax deficiency of ₱2,443.30; (b) franchise tax delinquency surcharge of ₱35,419.05 and (c) additional residence tax of ₱3,850. The Tax Court absolved taxpayer from payment of the first two amounts and required it to pay the third. The Commissioner appealed the judgment solely and exclusively as it freed the taxpayer, which did not appeal the portion adverse to it. Pending the appeal, the Government moved for execution of the judgment for ₱3,850 but the lower court denied it. Hence, this petition for certiorari and mandamus filed with the Supreme Court.

In granting the motion, the Supreme Court rejected the view that under section 4, Rule 41 of the Rules of Court, an appeal shall stay the whole judgment of the Court of Tax Appeals. The "decision which is stayed refers to that part thereof which is the subject-matter of the appeal, and no more." The premise, of course, is that the four conditions set out above are satisfied.

This rule further strengthens the collection arm of the Commissioner of Internal Revenue.

4. Liability of heirs and administrators

Suppose there are several administrators and heirs of the estate of the decedent. What is the liability of each for the estate and inheritance taxes? In the case of *Commissioner of Internal Revenue v. Gonzales*,[70] an administratrix was adjudged by the Supreme Court liable for the entire estate tax and inheritance tax, the latter amounting to ₱39,178.12. (The co-administratrix was not made a party.) She asked for reconsideration on the ground that since she administered only 1/3 of the estate, she should be made liable for only 1/3 of the total taxes and the 2/3 by the other administratrix.

The Court denied reconsideration on the theory, originally taken by movant and sustained by the lower court, that in co-administration, the administratrices are regarded as one person, and the acts of one of them are deemed to be the acts of all. Said the Court:

> "At any rate, estate and inheritance taxes are satisfied from the estate, and are to be paid by the executor or administrator. Where there are two or more executors, all of them are *severally* liable for the payment of the estate tax. The inheri-

[70] G.R. No. 19495, April 24, 1967.

tance tax although charged against the account of each beneficiary, should be paid by the executor or administrator. Failure to pay the estate and inheritance taxes before distribution of the estate would subject the executor or administrator to criminal liability under Sec. 107(c) of the Tax Code."

The Court therefore deemed it immaterial that movant administered only 1/3 of the estate for her right to the estate comes after taxes. Ruled the Court:

"As an administratrix, she is liable for the entire estate tax. As an heir, she is liable for the entire inheritance tax although her liability would not exceed the amount of her share in the estate."

Since her share far exceeds the ₱39,178.12 being collected as inheritance tax, the original decision holding her liable for the whole sum is correct.

The above case, should not be understood as foreclosing an administrator's right under the Civil Code to reimbursement from the other administrator or heirs for their corresponding share in the estate and inheritance taxes paid by one of them. While collection of the tax is a matter between the administrator and the government, reimbursement concerns only the several administrators and heirs.

In the above case, the taxes were collected before distribution of the estate to the several heirs. Suppose the estate had been distributed and the administration closed before all the taxes had been collected? What is the remedy of the Commissioner of Internal Revenue? What is the liability of an heir?

These questions are answered in the case of *Commissioner of Internal Revenue v. Pineda,* as one of the heirs of deceased Atanasio Pineda.[71] Manuel Pineda received as his share property amounting to ₱2,500.00. After distribution, the Commissioner of Internal Revenue, on the basis of investigation made by his examiners, issued deficiency income tax assessments against the estate for 1945-1947, totalling ₱2,707.44 plus residence tax and real estate dealer's tax. The lower court, upon instructions from the Supreme Court[72] found that the right to assess for 1947 had prescribed and only the total amount of ₱760.28 remained to be collected from the estate as income tax for 1945 and 1946 and

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[71] G.R. No. 22734, September 15, 1967.

[72] Collector of Internal Revenue v. Pineda, G.R. No. 14522, May 31, 1961.

real estate dealer's tax for 1947, but of this amount, heir Manuel B. Pineda was liable only for his corresponding share. The Commissioner appealed, contending that Pineda should be made to pay the entire tax liability of the estate.

The Supreme Court sustained the Commissioner and held Pineda liable for payment of the total tax liability of the estate, considering that the same did not exceed his share of the estate:

> "As a holder of property belonging to the estate, Pineda is liable for the tax up to the amount of the property in his possession. The reason is that the Government has a lien on the ₱2,500 received by him from the estate as his share in the inheritance, for unpaid taxes, for which said estate is liable."

(By virtue of the lien created by section 315, Tax Code.) But the Court stated that "after such payment, Pineda will have a right of contribution from his co-heirs, to achieve an adjustment of the proper share of each heir in the distributable estate. The Court then summarized the collection remedies available to the Commissioner in collecting tax liabilities of an estate that had been distributed to the heirs. The Commissioner may either (1) sue all the heirs and collect from each of them the amount of the tax proportionate to the inheritance received, or (2) by virtue of the lien created under section 315, Tax Code, sue only one heir and subject the property he received from the estate to the payment of the tax. The first was followed by the Commissioner in the case of *Govt. of the P.I. v. Pamintuan.*[73] The first remedy achieves two results, payment of the tax and adjustment of the shares of each heir in the distributed estate as lessened by the tax. The second remedy was adopted in the instant case, which seeks only one result: collection of the full tax. The adjustment of the shares of the heirs, as lessened by the tax, must await the appropriate suit for contribution by the heir from whom the Government recovered the tax. The Supreme Court observed that the Commissioner of Internal Revenue is given the necessary discretion to choose which remedy to adopt, considering that "taxes are the lifeblood of government and their prompt and certain availability is an imperious need."

The only protection of an heir, by these cases, is that his liability for the unpaid taxes of the estate cannot exceed his share in the inheritance.

[73] 55 Phil. 13 (1930).

5. Tax liens

Title IX, General Administrative Provisions, Tax Code, governs the creation and enforcement of tax liens. The term "lien" was defined by the Supreme Court in the case of *Hongkong & Shanghai Banking Corp. v. Rafferty,*[74] thus:

> "A lien, in its modern acceptation, is understood to denote a legal claim or charge on property, either real or personal, as security for some debt or obligation. Its meaning is more extensive than the Jus retentionis (derecho de retencion) of the Civil Law."

We have seen in the case of *Commissioner v. Pineda, supra,* how the unpaid tax liability of decedent's estate was collected by the Commissioner of Internal Revenue via the "tax lien" created by section 315, Tax Code. We have also seen in the case of *Collector of Internal Revenue v. Pio Barretto Sons, Inc.,*[75] how the lien on forest products for collection of the forest charges had been enlarged. There the Supreme Court, under the guise of safeguarding revenue, held that the lien for forest products is not merely a legal claim or charge on the "property," the forest products felled, but the personal liability of whoever is the possessor of the forest products and on him belongs the burden of proving by auxiliary and official invoices that the forest charges due had been paid. Failing to do so, he must pay the forest charges, regardless of whether or not he is a concessionaire.

In the case of *Guerrero v. Commissioner of Internal Revenue,*[76] the Supreme Court, coasting along the same trend it established in the *Pio Barretto* case, extended the rule on tax lien for forest charges so that a concessionaire no longer in possession of the forest products was made liable for payment of the tax due. There, the logs on which the forest charges being demanded were imposed, had been sold to a dealer and were no longer in the possession of the concessionaire. The Supreme Court applied the Barretto rule that these charges "are liens on the products and collectible from whomsoever is in possession" thereof "unless he can show that he has the required auxiliary and official invoice and discharge permit", although taxpayer no longer possessed the property.

[74] 39 Phil. 145 (1918).
[75] See note 33, *supra.*
[76] See note 36, *supra.*

a. *Taxes include fees and charges*

Previous to the *Barretto* and *Guerrero* cases, there had been conflicting contentions distinguishing "tax" on the one hand and "fee" or "charge" on the other. To clarify this matter, the Supreme Court, in the *Guerrero* case, held that for purposes only of the general administrative provisions of the Tax Code, Title IX, the word "taxes" includes not only "taxes" in the technical sense, but also all "fees" and "charges" imposed by the National Internal Revenue Code. In this context, forest charges which are fees for the privilege of severing forest products, mining *ad valorem* charges and mining royalties which are fees for extracting minerals from the earth, are all taxes. Said the Court:

> "In other words, the National Internal Revenue Code *makes a distinction* between *taxes*, on the one hand, and *fees or charges* on the other; *but as used in Title IX of said Code*, the term "tax" *includes* 'any national internal revenue tax, *fee or charge* imposed by' the Code."

This interpretation further rules out any attempt to hedge against the collection of "fees or charges" pursuant to the tax lien provisions of Title IX, Tax Code.

b. *Preference of credits*

Another aspect in the collection of taxes is the competition offered by other claims against the property or assets of a taxpayer. In the case of *The Chief of Staff, AFP v. Collector of Internal Revenue, et al.,*[77] several claims, including that for sales taxes, were made against the proceeds of confiscated cargo. Unfortunately, the proceeds were much less than the claims. Hence, the Chief of Staff, as custodian, filed this suit for interpleader. The claimants for freightage and labor contended that under the Spanish Civil Code of 1889 (that governed because the transaction occurred in 1948), Article 1922 on preference of credits, taxes are not mentioned as entitled to preference or lien. The Supreme Court pointed out, however, that section 315 of the Tax Code, provided that internal revenue tax on property or on business or on occupation and on resources and receipts shall constitute a lien superior to all other charges or liens. On this basis, it ruled that the lien for sales taxes attached from the moment they were due and continued until paid. There being no fixed duration in section 315, Tax Code, the Supreme Court held that

[77] G.R. No. 21835, August 19, 1967.

the provisions of sections 331 or 332 applied. The Court also held that the posting of a surety bond to answer for payment of the tax due did not dissolve the lien. Hence, it ordered that claim for sales taxes be satisfied first before the other claims.

It will be noticed from all these cases that invariably, the Supreme Court has refused to embarrass the power of the Commissioner of Internal Revenue to collect taxes, and where construction of the power was necessary, it did not hesitate to construe liberally for the effectiveness of said power.

6. Deficiency interest and surcharges.

For nonpayment or late payment of taxes, fees and charges imposed by the National Internal Revenue Code, civil penalties in the form of interest and surcharges are collected. Similarly, payment of a lesser amount than the income tax due invites the so-called deficiency interest, which is assessed at the same time as the deficiency.[78]

What is the nature of the deficiency interest? The Supreme Court answered this question in the case of *Central Azucarera Don Pedro v. Court of Tax Appeals.*[79]

In that case, the Commissioner of Internal Revenue assessed deficiency income tax against the taxpayer on October 15, 1959, some four months after the effectivity of Rep. Act No. 2343, which imposed for the first time interest on deficiency. The deficiency assessment involved 1954 and other years prior to the effectivity of the amendatory act, Rep. Act No. 2343. Respondent Commissioner computed the 1/2% monthly interest (not to exceed 18%) starting only from the date of effectivity of Rep. Act No. 2343 or June 20, 1959. Taxpayer resisted the addition of the deficiency interest contending that would make the act retroactive, hence illegal. Additionally, imposing the deficiency interest for past tax years would according to it violate the prohibition against *ex post facto* laws guaranteed in the Constitution. The theory of taxpayer was that deficiency interest before the amendment accrued only when taxpayer failed to pay the tax within the period prescribed by the Commissioner. The

[78] Tax Code, Sec. 51 (d).
[79] G.R. Nos. 23236 & 23254, May 31, 1967.

Supreme Court disagreed and said that even before the amendment, deficiency interest was imposable in case of non-payment on time, not only on the basic income tax but also on the deficiency.[80] Since the respondent imposed the deficiency interest at the same time that he assessed the deficiency and imposed the 1/2% monthly interest only from the effectivity of the amendment, there was no retroactive application of the law. The Court pointed out that the amendment even worked to the advantage of the taxpayer. Under the old law, section 51(d), Tax Code, the deficiency rate was 1% monthly, from due date of the tax, until paid. Under the new law, section 51(d) as amended by Rep. Act No. 2343, the rate was only 1/2% per month, not to exceed 36 months.

The Court also rejected the second objection of taxpayer that the deficiency interest, if applied to previous years when it earned the income, was *ex post facto*. It held that the collection of interest is not penal in nature:

> "'The imposition of . . . interest is but a just compensation to the state for the delay in paying the tax, and for the concommittant use by the taxpayer of funds that rightfully should be in the government's hands (U.S. v. Goldstein, 189 F.2d 752; Ross v. U.S. 148 Fed. Supp. 330; U.S. v. Joffray, 97 Fed. 2d 488). The fact that the interest charged is made proportionate to the period of delay constitutes the best evidence that such interest is not penal but compensatory'. (Castro v. Coll. of Internal Revenue, G.R. No. L-12174, Resol. Motion for Reconsideration, December 28, 1962)."

The Court also cited its previous decisions that

> "The doctrine of unconstitutionality raised by appellant is based on the prohibition against *ex post facto laws*. But this prohibition applies only to criminal or penal matters, and not to laws which concern civil matters or proceedings, generally, or which affect or regulate civil or private rights (Ex parte Garland, 18 Law Ed., 366; 16 C.J.S. 889-891). '(Republic v. Oasan Vda. de Fernandez, 99 Phil. 934, 937)'."

It seems therefore that with these cases cited, the applicability of the interest provisions in section 51(d) as amended by Rep. Act. No. 2343 to income earned before 1959, is now a settled question.

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[80] Tax Code, Sec. 51 (d).

7. Late payment surcharges

The other internal revenue taxes have their respective due dates for payment, and if paid late, are increased generally by 25% surcharge. This is true with the franchise tax.

Earlier, this survey discussed the problem of franchises granted by prior acts at smaller rates than that imposed by section 259, Tax Code. Most of the franchise holders believed in good faith despite the introduction of higher rates, they continued to be subject to the lower rates provided in their respective franchises. In some cases, the Commissioner of Internal Revenue even expressed his conformity with such belief. We have seen that the settled law now is that the higher rate of section 259, Tax Code, applied without violence to the impairment clause of the Constitution because the State reserved the power to alter or modify the franchise granted. Hence, the question arises whether or not the late payment of the correct franchise tax pursuant to section 259 is subject to the 25% surcharge as provided therein.

The Supreme Court answered in the negative in the two cases of *Imus Electric Co., Inc. v. Court of Tax Appeals,*[81] and *Guagua Electric Light Plant Company, Inc. v. Collector of Internal Revenue.*[82] Thus stated the Supreme Court in the latter case:

> "With regard to the 25% surcharge in the amount of . . . . , it is patently unfair on the part of the Government to require its payment inasmuch as taxpayer acted in good faith in paying the franchise tax at the lower rates fixed by its franchises. As a matter of fact, the Bureau of Internal Revenue shared with the taxpayer the view that Section 259 of the Tax Code does not apply. Guagua Electric should not therefore be made to pay the 25% surcharge."

In the Imus case, the Supreme Court relied on the case of *Connell Bros., Co. v. Collector of Internal Revenue*[83] in dispensing with the surcharge of 25% where delay was due to taxpayer's good faith. The Connell case involved sales tax, also sanctioned by a 25% surcharge for late payment.

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[81] G.R. No. 22421, March 18, 1967.
[82] G.R. No. 23611, April 24, 1967.
[83] G.R. No. 15470, December 26, 1963, 62 O.G. 8631 (Nov., 1966).

V. INTERNAL REVENUE CASES — JURISDICTION

A. *Disputed assessments*

Republic Act No. 1125 created the Court of Tax Appeals to take exclusive appellate jurisdiction to review disputed assessments of the Commissioner of Internal Revenue (as well as refunds, penalties and other matters arising under the Tax Code).[84] Section 11 thereof gives the taxpayer adversely affected by a decision or ruling of the Commissioner of Internal Revenue 30 days from receipt of the decision within which to appeal to the Tax Court. Since this period is jurisdictional, it is of vital importance to know what constitutes the appealable decision, because from its receipt, counting of the period becomes a mechanical operation.

This has been a bothersome question from the beginning, but the number of cases decided by the Tax Court and the Supreme Court have somewhat clarified matters. The 1967 cases decided by the Supreme Court hewed closely to the guidelines set by earlier cases.

In the case of *Filipinas Investment & Finance Corp. v. Comm. of Internal Revenue,*[85] the lower court dismissed taxpayer's petition for want of jurisdiction because filed more than 30 days from receipt of the decision. In that case, the BIR issued an assessment for advance sales tax dated April 18, 1961 on an automobile purchased from a tax-exempt party. Taxpayer contested the same in a letter dated May 15, 1961, requesting therein that the assessment be cancelled and/or withdrawn. Respondent Commissioner, in a letter dated Aug. 17, 1962, denied taxpayer's request. (No date of receipt by taxpayer of this decision appears in the record.) On Oct. 1, 1962, taxpayer filed a letter dated Sept. 28, 1962, requesting cancellation of the assessment. In the meantime, letters from the BIR regional office demanded payment of the assessed amount, to which taxpayer replied by referring to his pending 2d request for cancellation. Through counsel, taxpayer made a 3d request for cancellation. On August 12, 1963, taxpayer received a decision of the Commissioner dated July 22, 1963, denying the 2d and 3d requests of taxpayer. Hence, it appealed to the Tax Court which dismissed as stated

[84] Rep. Act No. 1125 (1954), Sec. 7.
[85] G.R. No. 23501, May 16, 1967.

above, for petitioner spent 33 days from receipt of the decision. The lower court computed as follows:

Sept. 28, 1962, deemed date of receipt of decision to Oct. 1, 1962	3 days
Aug. 12, 1963, date of receipt of denial of request for reconsideration to Sept. 11, 1963, filing of appeal ..	30 days
	33 days

The Supreme Court affirmed, agreeing that the assessment of April 18, 1961 became "disputed" when taxpayer requested for its cancellation and/or withdrawal in a letter dated May 15, 1961. Respondent's letter of August 17, 1962, denying the request was the decision on the disputed assessment. That was the appealable decision to the Tax Court. The Supreme Court concluded that

> "the period to appeal from a decision of the Commissioner of Internal Revenue to the Tax Court under R.A. No. 1125 is jurisdictional and non-extendible, and that a taxpayer may not delay indefinitely a tax assessment by reiterating his original defenses over and over again, without substantial variation . . ."

1. Assessment before collection

In the course of a trial, there might escape the watchful eyes of counsel evidence tending to show that the taxpayer is liable for a bigger amount of tax than what is being collected in the appealed decision. In such a case, may the Commissioner amend his pleading or his prayer so as to include collection of the bigger amount justified by the evidence? The Supreme Court said "no" in the Guerrero case.[86]

During the trial of that case, taxpayer introduced certain invoices showing that he had evaded payment of forest charges on additional logs to those included in the assessment. Commissioner maintained that evidence

> "introduced without objection becomes property of the case and all parties are amenable to any favorable or unfavorable effects resulting from the evidence." (Citing Beam v. Yatco, 82 Phil. 30.)

The Supreme Court rejected the theory of the respondent by pointing out that the doctrine quoted dealt with plaintiff's right to recover, when his own evidence proves the contrary.

> "In short, it refers to a *point in issue.* In the case at bar, the *additional* logs under consideration were not *included* in the

[86] See note 36, *supra.*

> contested assessments. Since the jurisdiction of the Court of Tax Appeals is purely appellate, said Court correctly declined to make an award thereon for lack of jurisdiction over the same."

The other side of this rule was also applied by the Tax Court adversely to the taxpayer in a case involving refund of taxes erroneously paid. During the course of the trial, taxpayer, without objection from the BIR counsel, introduced official receipts increasing the amounts erroneously collected. Taxpayer then amended its pleading increasing the amount to be refunded. The Tax Court denied the motion on the ground of lack of jurisdiction because the bigger amount was not in dispute administratively.[87]

B. *Res judicata*

The case of *Auyong Hian v. Commissioner of Internal Revenue,*[88] illustrates the efforts of counsel to challenge assessments regardless of orderly procedure. In that case, the Republic of the Philippines filed a collection suit for deficiency income taxes for the tax years 1946 through 1951. It won in the CFI in a judgment dated July 12, 1963. This was appealed to and affirmed by the Court of Appeals; the Supreme Court denied taxpayer's petition for certiorari. Some two months after the judgment of the CFI was promulgated, taxpayer appealed the same assessment, for the same tax years and the same amounts, to the Court of Tax Appeals which dismissed the same because filed beyond 30 days from receipt for the assessment and there is another action pending between the same parties for the same cause of action. Reconsideration was denied, hence taxpayer appealed to the Supreme Court in the instant case.

The Supreme Court dismissed on the ground of res judicata. The issues have become moot and academic. When the Supreme Court denied the certiorari in the first case, implicit was its

> "unqualified approbation of the Court of Appeals decision. With the finality of this Court's resolution dismissing the petition for certiorari, the question as to the amount of the deficiency income taxes of Auyong Hian for 1946-1951 inclusive, became settled matter. The correctness of these assessments may not now be inquired into. Because '(p)ublic policy and sound prac-

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[87] Japan Air Lines v. Commissioner of Internal Revenue, CTA Case No. 1634, July 5, 1967.
[88] G.R. No. 23395, October 31, 1967.

tice demand that, at the risk of occasional errors, judgments of courts should become final at some definite time fixed by law', and '(t)he very object for which courts were instituted was to put an end to controversies'."

This case emphasizes the importance of contesting assessments in the Court of Tax Appeals within the period allowed, otherwise it becomes most difficult to defend against a collection suit in the court of first instance. As this case illustrates, the case cannot be channeled back to the Court of Tax Appeals.

VI. CUSTOMS CASES

A. *Exclusive jurisdiction of the Tax Court*

Among the powers vested in the Court of Tax Appeals by Rep. Act No. 1125 is exclusive appellate jurisdiction to review by appeal

"(2) Decisions of the Commissioner of Customs for customs duties, fees or other money charges; seizure, detention or release of property affected; fines, forfeitures or other penalties imposed in relation thereto; or other matters arising under the Customs Law or other law or part of law administered by the Bureau of Customs."[89]

The Tariff and Customs Code has outlined the procedure of contesting rulings or decisions involving liability for duties, fees or other money charges. The importer must file with the Collector a written protest within 30 days from date of payment after final liquidation. In protestable cases, this remedy is exclusive, that is, payment first, then protest. If not satisfied with the ruling or decision of the Collector of the Port, the importer must appeal to the Commissioner of Customs within 15 days. If still not satisfied, he can go to the Tax Court within 30 days, thence to the Supreme Court.[90] The cases have established the rule that the administrative procedure is jurisdictional and only decisions of the Commissioner of Customs can be brought to the Tax Court.

1. Protest exclusive

In the case of *Hawaiian-Philippine Co. v. Auditor General*,[91] the Supreme Court applied this procedure to deny a claim for refund of wharfage fees filed directly with the Auditor General

[89] Rep. Act No. 1125 (1954), Sec. 7.
[90] Tariff Code, Secs. 2308-2314, 2402; Rep. Act No. 1125 (1954).
[91] G.R. No. 18440, October 25, 1967.

as provided under Act No. 3083, Com. Act No. 327 and Articles 2154 and 2155 of the Civil Code governing *solutio indebiti.*

There, the importer paid wharfage fees on its export although it did not use any government wharf or facility. Believing that it paid correctly, it did not interpose any protest. Subsequently, long after the period allowed by law for filing protests, petitioner claimed for refund of the wharfage fees with the Collector of Customs of Iloilo, based on the decision of the Supreme Court in *Commissioner of Customs v. Superior Gas & Equipment Co.* (SUGECO).[92] That case directed refund of wharfage fees paid on importations unloaded on private wharf, pursuant to the provision of then existing law, Rep. Act No. 1371, exempting importations unloaded on private wharves. The Collector denied the claim of Hawaiian-Philippine, on the ground that the Sugeco case was not applicable. Petitioner went directly to the Auditor General, who denied the claim for refund, on the ground that the matter was within the exclusive jurisdiction of the Bureau of Customs.

In the Supreme Court, Hawaiian-Philippine rested on the theory that the procedure outlined in customs law did not apply for its payment was not a protestable case.

The Supreme Court, reiterating its decision in *Victorias Milling Co., Inc. v. Auditor General,*[93] affirmed the denial made by the Auditor General. The payment of wharfage fee was a protestable case and therefore section 1371 of the Administrative Code[94] applied. Said the Court in the Victorias case, quoted with approval in the instant case:

> ". . . the law refers to cases that are *protestable,* not protested, cases *subject to protest,* not the *object of protest.* To adopt the view of petitioner would be to place the applicability of section 1371 at the exclusive determination of those precisely intended to be bound by it. We therefore hold that the instant case comes within the purview of sections 1370 and 1371 of the Revised Administrative Code (preserved as Sections 2308 and 2309, Tariff and Customs Code) prescribing the manner of enforcing a claim against the imposition and collection of customs duties, fees or other money charge under our customs laws. And this remedy or procedure being exclusive in these matters, the Auditor General has no power to entertain the same even though presented in another form."

[92] G.R. No. 14115, May 25, 1960.
[93] G.R. No. 17414, November 30, 1962, 62 O.G. 1009 (Feb., 1966).
[94] Predecessor of Sec. 2309 of the Tariff Code.

In this connection, the Supreme Court again held that wharfage is due even on cargo loaded (or unloaded) without the use of a government wharf (See **infra** wharfage)

2. Legality of importation

CFI no jurisdiction. Where the Commissioner of Customs detains an importation pending his determination of whether or not the same is legal, the importer has to wait for a decision before he can appeal, and such appeal must be filed with the Tax Court, not with the court of first instance. In brief, this was the holding of the Supreme Court in the case of *Commissioner of Customs v. Cloribel.*[95] In that case, Teves imported some Toyopet cars and other items, pursuant to a contract with the NARIC to buy and export rice purchased from the NARIC. Upon refusal of the Commissioner to release these importations before compliance with certain conditions, like clearance by the Office of Economic Coordination, the importer offered to secure the release with surety bonds. This was accepted and the goods were released. Later, he went to the court of first instance and on the ground that his importation was legal, he asked that the requirements set by the Commissioner of Customs not be enforced and the surety bond he filed be cancelled. This was granted by the CFI so that the Commissioner asked the Supreme Court to review the matter by certiorari.

The Supreme Court granted the prayer of the Commissioner holding that the CFI had no jurisdiction to determine the question of legality of importations, a subject placed by Rep. Act No. 1125 exclusively within the jurisdiction of the Court of Tax Appeals. After quoting section 7(a) of Rep. Act No. 1125, the Supreme Court stated:

> Jurisprudence is not wanting which should show that Sec. 7 of R.A. 1125 has taken away from the power of courts of first instance to review the actuations of the customs authorities in a case involving seizure, *detention* or release of property, or other matters arising under the Customs Law or other law administered by the Bureau of Customs . . . (citing Millares case, 97 Phil. 282, 284-285.)

The Court stated categorically that the "authority to rule on the legality of the importation still rests with Customs autho-

[95] G.R. No. 20266, January 31, 1967.

rities; appeal from the decision of the Commissioner is to the Court of Tax Appeals." The Supreme Court further ruled that even if the CFI had jurisdiction, its exercise under the circumstances shown constituted a clear case of abuse of discretion.

The above case was followed in *Acting Collector of Customs of the Port of Manila v. Caluag.*[96] That case involved a so-called "hot car" purchased by Calalang on which no advance sales tax or compensating tax had been paid. The car originally belonged to a tax-exempt military personnel of the United States. The Acting Collector of Customs issued warrant of seizure and detention and the car was seized. Calalang filed with the CFI a petition for certiorari, mandamus and prohibition, with preliminary mandatory injunction against the opposition of the Acting Collector of Customs. Since the CFI granted preliminary mandatory injunction, the Government instituted a petition for certiorari and prohibition against the CFI, based on want of jurisdiction. The Supreme Court granted the petition as stated above, reiterating that

> Statute as well as jurisprudence are very clear, however, that it is the Court of Tax Appeals, and not the Court of First Instance, that has jurisdiction to review the actuations of the Customs authorities in regard to seizure, detention or release of property affected . . ." (Millarez v. Amparo, 97 Phil. 282, 284-285 cited.)

The Court said that while Calalang no doubt "has the right to question the legality of the seizure," she must do so in the proper court, the Tax Court, and not in the court of first instance.

To the contention that section 7, Rep. Act No. 1125 did not apply for there was no decision of the Commissioner of Customs that can be appealed to the Tax Court, the Court answered that the same is not only without merit but even argues against Calalang, for it proves she did not exhaust the administrative remedies made available by law. The Court bolstered its opinion by observing that there were other remedies immediately available, like filing sufficient bond to secure release and/or filing protest with the Collector. These remedies, said the Court, weighed heavily against certiorari which is issued only in the absence of any other plain, speedy and adequate remedy in the ordinary course of law.

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[96] G.R. No. 23925, May 24, 1967.

3. Personality to appeal surety

In a series of cases, the Court of Tax Appeals had ruled that a surety for the release of imported goods seized and detained for violation of applicable rules and regulations did not have personality to appeal the legality of the seizure to the Tax Court.[97] This view was upheld by the Supreme Court in the case of *Phil. Int'l. Surety Co., Inc. v. Court of Tax Appeals.*[98] In that case, the Bureau of Customs seized importations made by an importer for lack of release certificate and import license required by Central Bank Regulations Nos. 44 & 45. Nonetheless, the goods were released under a surety bond posted by herein petitioner as surety and the importer as principal. The Collector of Customs decided that the importation was illegal, declared the goods forfeited and ordered payment of the amount due. The importer appealed to the Commissioner of Customs who affirmed his subordinate. While the petitioner-surety did not appeal to the Commissioner, it filed a request for reconsideration; the Commissioner denied the request, and the surety appealed to the Tax Court. The lower court, as stated above, dismissed, for lack of personality of a surety to appeal. This decision was elevated by the surety to the Supreme Court.

The highest court affirmed the decision of the lower court, by noting that the surety did not appeal from the decision of the Collector to the Commissioner of Customs. Thus, assuming that it had personality to appeal, "the same was lost". The surety contended that it did not receive notice of the decision of the Collector, hence its failure to appeal the same. The Supreme Court, however, did not give credence to this argument for the evidence showed that notice of such decision was furnished the surety. Moreover, the lower court already considered the case on the merits and found that Central Bank Regulations Nos. 44 and 45 were valid.

Again, this case illustrates the point that for an appeal to prosper against a decision or ruling of the Collector of Customs, the same must first be appealed seasonably to the Commissioner

[97] Philippine International Surety Co., Inc. v. Commissioner of Customs, CTA Case No. 770, June 26, 1963; CTA Case No. 771, January 4, 1963; Philippine International Surety Co., Inc. v. Commissioner of Internal Revenue, CTA Case No. 760, May 31, 1963; Philippine International Surety Co., Inc. v. Commissioner of Customs, CTA Case No. 930, July 27, 1963; CTA Case No. 1183, December 7, 1963.

[98] G.R. No. 22420, March 18, 1967.

of Customs. It is the decision of the later official that can be reviewed by the Tax Court.

This rule was applied by the Supreme Court in the later case of *Romualdez v. Arca.*[99] In that case, the Collector of Customs seized the vessel of a lessor because the lessess used it to smuggle untaxed "blue seal" cigarettes, thus violating section 2530 (a), (b) and (c) of the Tariff and Customs Code. Instead of appealing the decision of the Collector of Customs to the Commissioner, the owner of the vessel sought its release under bond in a petition filed with the court of first instance, with a prayer for preliminary mandatory injunction. The Collector of Customs opposed on the ground that petitioner has not exhausted its administrative remedies and the court had no jurisdiction. On the basis of its general original jurisdiction over all cases involving property valued at over ₱10,000,[100] the court of first instance assumed jurisdiction and granted the writ for preliminary mandatory injunction. Hence, this petition for certiorari in the Supreme Court.

The Supreme Court dissolved the writ and held that the court of first instance had no jurisdiction over customs cases involving seizure and forfeiture. It said:

> "Section 2530 of the Tariff and Customs Code lists the kinds of property subject to forfeiture and also the procedure in seizure and forfeiture cases, vesting in the Collector of Customs authority to hear and decide such cases. Thus, the Collector's decision is appealable to the Commissioner's Office and then to the Court of Tax Appeals and from the latter, to the Supreme Court."

While the Court observed that this runs counter to the original jurisdiction of courts of first instance over all cases involving over ₱10,000, it held that it already decided that the jurisdiction of the Collector of Customs should prevail, reiterating said decision as follows:

> "In Pacis v. Averia, L-22526, 11-29-66, We already held and We herein reiterate that the jurisdiction of the Collector of Customs should prevail because, aside from the fact that R.A. 1937 (Tariff and Customs Code) was a later law, having taken effect in 1957, on grounds of public policy it is more reasonable to conclude that the legislators intended to deprive the courts of first instance of their authority to intervene with property

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[99] G.R. No. 20516, November 15, 1967.

[100] Rep. Act No. 296 (1948), Sec. 44 (c) as amended by Rep. Act No. 3838 (1963).

subject to seizure and forfeiture proceedings for violation of the Tariff and Customs Code. Besides, We said Section 2303 of the same Code requires the Collector of Customs to give the property owner written notice of the seizure and of the opportunity to present his defense. This provision is clearly indicative of the law's intent to confine in the Bureau of Customs the determination of all questions affecting the disposal of property in a seizure and forfeiture case, subject to the judicial remedy of the property owner, not in the court of first instance but in the Court of Tax Appeals — and only after exhausting administrative remedies in the Bureau of Customs."

As in the *Caluag* case,[101] the contention was made by the vessel owner that Rep. Act No. 1125 would not apply because there was no decision of the Commissioner of Customs to appeal to the Tax Court. Similarly, the Supreme Court answered that this contention argued against the petitioner, for it showed non-exhaustion of administrative remedies in the Bureau of Customs.

The case of *Auyong Hian v. Court of Tax Appeals,*[102] presents the unusual case of a court refusing to exercise jurisdiction which it had under the law and under the facts. The importer in that case imported 600 hogsheads of Virginia leaf tobacco under licenses issued on the expiry date of the Import Control Law on June 30, 1953. The importation arrived in 1961, or over eight years later, when it was prohibited to import tobacco leaf under a no-dollar license. Doubting its legality, the Collector of Customs refused to release. The importer filed a petition in the court of first instance for mandamus to release; the court granted mandamus on the theory that the import licenses were valid. The matter was elevated to the Supreme Court.[103] The Supreme Court ruled that the court of first instance had no jurisdiction and that the importation was illegal because it arrived long after the expiration of the Import Control Law when such importation contravened public policy.

Shortly thereafter, the Collector instituted seizure proceedings and declared the tobacco forfeited and ordered its sale at public auction. Importer filed a timely notice of appeal to the Commissioner. Pending decision by the Commissioner, numerous incidents of the case arose, leading to another case in the

[101] See note 96, *supra.*
[102] G.R. No. 25181, January 11, 1967.
[103] Climaco v. Barcelona, G.R. No. 19597, July 31, 1962.

Supreme Court,[104] in which the Supreme Court, deciding again the issue of jurisdiction, stated that the importation was illegal. In that case, the Supreme Court noted that the case was pending appeal in the Office of Commissioner and refrained from taking cognizance of its administrative phase.

The Commissioner of Customs affirmed the decision of the Collector, and the importer filed a timely appeal to the Court of Tax Appeals.

The Court of Tax Appeals dismissed, stating that it had no jurisdiction. After referring to the Barcelona and Arca cases, where the Supreme Court already declared that the importation was illegal, the Tax Court concluded that it

> "cannot review, revise, much less overrule the decisions of the Supreme Court". (C.T.A. 1560, resolution 6-2-65.)

The Supreme Court held otherwise, that the Tax Court had jurisdiction over the case under the law and the facts, and remanded the case for further proceedings in the court below.

In arriving at its conclusion, the Supreme Court reviewed the pertinent provisions on jurisdiction of the Tax Court in matters involving seizure proceedings. Thus, section 2314, Tariff and Customs Code, gives to the Commissioner of Customs power of review over decisions of the Collector where the aggrieved person gives written notice thereof within 15 days from being notified of the adverse decision. Then, under section 2402, same Code, the party aggrieved by the decision of the Commissioner of Customs may appeal to the Tax Court. Section 7, Rep. Act No. 1125, provides the manner of appeal to said court, that is, the aggrieved party must appeal within 30 days from receipt of the decision of the Commissioner. The Supreme Court noted that the importer-petitioner has properly complied with all these requirements and that the "subject matter of the appeal is perfectly within the power of the Court of Tax Appeals to hear and decide."

As if disturbed by the basis of the lower court's refusal to take cognizance of the case, the declaration of the highest court that the importation was illegal, the Supreme Court devoted a lengthy portion of its decision to answer this point.

[104] Collector of Customs v. Arca, G.R. No. 21839, July 17, 1964, 63 O.G. 6825 (Aug., 1967).

The Supreme Court stated that in the first place, the appeal to the Tax Court raised other matters than the legality of the importation. Thus, the question whether or not tobacco was relatively or absolutely prohibited was raised; this was not raised in the Barcelona and Arca cases. Similarly, the appeal in the Tax Court related to matters involving seizure, forfeiture and disposition of the importation, like its sale at public auction. These matters could not have been raised in the earlier cases cited for the Collector had not yet instituted seizure proceedings and the Supreme Court could not have decided these matters. If the Supreme Court declared that the importation was illegal, it was only to dispose of the issue of jurisdiction of the court of first instance, considering that in the *Barcelona* case, the court assumed jurisdiction on the theory that the importation was legal for the import licenses were valid.

The Supreme Court also pointed out that in the Arca case, it recognized that the administrative phase of the case was still pending in the Office of the Commissioner and therefore it, the Supreme Court, refused to dispose of the administrative question. There were numerous portions of the *Barcelona* and *Arca* cases, said the Court, where it recognized the jurisdiction of the Tax Court over the administrative matters of the case. Said the Supreme Court:

> "It will thus be seen, from the above-quoted resolutions issued in connection with incidents brought up after the decision had been rendered in the Arca case, that in spite of the fact that this Court had declared the importation of the 600 hogsheads of tobacco in question illegal, it categorically declared that the Court of Tax Appeals has the exclusive jurisdiction over the subject matter (the tobacco) pursuant to the appeal . . . from the decision of the Commissioner of Customs. What are said in these resolutions are but reaffirmations of what we stated in the decision that because of the timely appeal made . . . . , this Court would refrain from passing upon the validity of the administrative proceedings. This Court recognizes the exclusive jurisdiction of the Court of Tax Appeals over appeals in administrative proceedings in connection with importations. Indeed, the proceedings before the Collector of Customs, the appeal before the Commissioner of Customs, and the appeal before the Court of Tax Appeals deal with the administrative aspects of importation. While the Court of Tax Appeals is considered as a judicial body, its functions are to pass upon the administrative decisions of the Commissioner of Customs, the Commissioner of Internal Revenue and the Boards of Assessment Appeals.'

These considerations support the conclusion that the Tax Court had jurisdiction to entertain the appeal from the decision of the Commissioner of Customs.

B. *Wharfage fees*

Section 2802, Tariff and Customs Code, effective 1957, imposes on cargo imported into or exported from the Philippines, wharfage fee of ₱2 per metric ton. This fee was also collected under section 3, Rep. Act No. 1371, effective 1955, but the proviso therein exempted importations unloaded on private wharves. In turn, section 3, Rep. Act No. 1371, minus the proviso, was reproduced from section 14 of the Tariff Act of 1909. Said section 14 was administered by the Bureau of Customs so that wharfage dues were collected on cargo loaded or unloaded in the Philippines although no government wharves or facilities were used. Such administrative practice was approved by the Supreme Court in the case of *Philippine Sugar Centrals Agency v. Insular Collector of Customs.*[105] However, in a case that arose under section 3, Rep. Act No. 1371, the Supreme Court, in exempting the importation of cargo unloaded in private wharf, expressed the opinion that the

> "discussions in the Legislature (at the time of enactment of R.A. 1371) showed the intention not to levy the wharfage fees on merchandise unloaded at places other than Government wharves or without making use of pier facilities"

reproducing the debates on this point. The Supreme Court then concluded

> "That in other words, the Congress at last accepted the ordinary concept of 'wharfage charge' or the 'charge for use of wharf by way of rent or compensation' or the 'money paid for loading goods upon, or loading them from a wharf' or the 'fee or duty for the privilege of using a wharf' and admitted that goods not landed via the Government wharves should not pay wharfage." (Commissioner of Customs v. Superior Gas & Equipment Co., et al., L-14115, 5-30-60.)

Taking a cue from the foregoing decision of the Supreme Court, many importers challenged the collection of the wharfage dues on cargo loaded or unloaded without the use of government wharves or facilities. The theory of these importers was that wharfage fee, as acknowledged by the Congress and the Supreme Court, was rental for the use of a wharf; if no government wharf was used, then the Government had no right to col-

[105] 51 Phil. 134 (1927).

lect, otherwise such act would deprive the owner of property without due process; and that to insist on collection, would make the wharfage fee a tax, and imposition of a tax by implication is legally frowned upon.

All the cases decided in the Tax Court rejected this position. In 1967, the Supreme Court answered these contentions for the first time. In the case of *Procter & Gamble Philippine Manufacturing Corp. v. Commissioner of Customs*,[106] the petitioner imported raw materials from San Francisco which it unloaded here without the use of any government wharves or facilities. The cargo was unloaded from the vessel onto private lighters which were towed to petitioner's private wharf. The Commissioner and the Tax Court both affirmed the collection of the wharfage fees by the Collector of Customs, hence the appeal to the Supreme Court. The case arose under the provisions of section 2802, Tariff and Customs Code, for 1958 importations were involved.

The Supreme Court upheld the decision of the Tax Court, which relied on statutory construction to show that the intention of Congress in enacting section 2802 was to impose wharfage on all cargo, whether or not loaded or unloaded with the use of government wharf. This was so, observed the lower court, for section 2802, while reproducing almost verbatim, the provisions of section 3, Rep. Act No. 1371, deleted the proviso of the latter exempting imports unloaded on private wharves. The Supreme Court apparently approved this reasoning for it made express reference to such deletion of the proviso.

A careful reading of the case, however, reveals that the conclusion of the Supreme Court was dictated by the belief that cargo entering Philippine ports and unloaded (or loaded) there received benefits from port facilities maintained by the Government and it was reasonable for such cargo to contribute to the cost of providing and keeping a safe port. Thus, it noted that the Tariff and Customs Code imposes charges on varying activities of a vessel entering Philippine ports:

> "For coming to the Philippines from a foreign port or for going to a foreign port from the Philippines, one pays tonnage dues. For entrance into or departure from a port of entry, harbor fees are collected. *Wharfage dues are assessed against the cargo* discharged by a vessel engaged in foreign trade. Berthing ...

[106] G.R. No. 22819, April 27, 1967, 63 O.G. 10602 (Nov., 1967).

charges are levied on a vessel coming or mooring within specified places or waters of a port.

"A vessel ordinarily enters a harbor and lays anchor or moors in a port to load, to unload or both. In doing so, the vessel derives benefit from port facilities provided and maintained by the Government. For this reason, they are in fairness made to contribute a share in said Government undertaking by payment of berthing charges and harbor fees. Similarly, cargoes discharged to a Philippine port from a vessel engaged in foreign trade derive benefit from port facilities provided and maintained by the Government; said cargoes should share the cost of providing and keeping a safe port in the form of wharfages dues."

Consistent with its reasoning, the Supreme Court concluded that wharfage "partake of the nature of a tax which is collected by the Government to support its operation in relation to customs affairs."

This case would seem to dispose of the numerous cases now pending and involving wharfage dues, as is shown in the Hawaiian-Philippine case.[107]

C. *Forfeiture and seizure*

Central Bank Circulars. — The Tariff and Customs Code empowers the seizure and forfeiture of imported articles for causes enumerated in section 2530,[108] among which are "merchandise of prohibited importation" or importation effected "contrary to law." Among the regulations enforced by the Bureau of Customs were Central Bank Circulars Nos. 44 and 45, in relation to section 1363, Revised Administrative Code. These circulars required Central Bank release certificates before any importation could be released. For violation of these circulars, the Bureau of Customs seized many importations. These gave rise to numerous cases in the courts, challenging the seizure and forfeiture, basically on two grounds: that the Tax Court cannot validly enforce these circulars for they had been repealed by Rep. Act No. 1410 (transferring authority to license no-dollar imports from the Central Bank to the No Dollar Import Office) and/or Central Bank Circular No. 133 (lifting dollar controls); and the repeal of these circulars by C.B. Circular No. 133 abated the liabilities incurred under them.

The Tax Court and the Supreme Court both definitively ruled that these circulars, insofar as they required release certificates

[107] See note 91, *supra*.

[108] Formerly Rev. Adm. Code, Sec. 1363.

for withdrawal of importations had not been repealed for the requirement was incorporated by or carried over to Circular No. 133. Neither did Rep. Act No. 1410 repeal Circular No. 45 for Rep. Act No. 1410 expressly excepted from its provisions goods in transit previously imported.[109]

In 1967, the Supreme Court decided another case in this category, which simply followed the earlier rulings made.[110] The Supreme Court there said that the CB circulars questioned were valid regulations enforceable by the Bureau of Customs, and their violation made the importation fall under the category of prohibited importation under section 1363(f), Revised Administrative Code.

D. *Basis of valuation, forfeiture*

In the Extensive Enterprises case, the importer also questioned the appraisal made by the Commissioner who included 30% of the estimated profit in the valuation. The importer insisted that the appraised value should be made pursuant to Rule 13 (a), section 2 of the Tariff Act of 1909, as amended, in relation to section 1280, Revised Administrative Code.[111] The method preferred by the importer based valuation on the actual market value of the goods in the place of importation, not in the local market as was done by the Commissioner. The Supreme Court upheld the method of appraisal made by the Commissioner, which is the proper method in the case of seizure proceedings.[112] On the other hand, the provision invoked by the importer governed determination of collectible duties, which is not involved in the instant case.

This case was followed in the cases of *Sare v. Aseron, Litton & Co. v. Comm. of Customs*[113] where the Supreme Court added, that assuming arguendo, as contended, that CB Circulars 44 and 45 were repealed, the repeal "did not have the effect of legalizing an importation which was made illegally prior to repeal". In the Litton case, the Court also reiterated its ruling that in appraising for purposes of forfeiture proceedings, the local mar-

[109] Bombay Dept. Store v. Commissioner of Customs, G.R. No. 20489, June 22, 1965; G.R. No. 20460, September 30, 1965; Lazaro v. Commissioner of Customs, G.R. Nos. 21790 & 21794, December 24, 1965; Pascual v. Commissioner of Customs, G.R. No. 12219, April 25, 1962.

[110] Extensive Enterprises Corp. v. Commissioner of Customs, G.R. No. 22515, April 27, 1967.

[111] Now Tariff Code, Sec. 201.

[112] Rev. Adm. Code, Sec. 1377; now Tariff Code, Sec. 2305.

[113] G.R. No. 22380, August 15, 1967; G.R. No. 22516, August 17, 1967.

ket value should be used, not the market value in the place of importation.

In the *Caluag* case,[114] we pointed out that the importer whose goods are subjected to forfeiture and seizure proceedings by the Collector cannot go to the Supreme Court by way of certiorari because administrative remedies are open to him — he could obtain release by filing bond, and or he could pay and then file a protest. In a way, the Supreme Court has shown to the importer some administrative remedies available in seizure and forfeiture proceedings, before resort is made to the Tax Court, and finally to the Supreme Court.

E. *Destruction of seized articles*

An interesting incident of seizure and forfeiture proceedings arose in the case of *Gonzales v. Ponce Enrile,*[115] where the taxpayer questioned a presidential directive to burn confiscated "blue seal" cigarettes. Petitioner was a lawyer and private citizen who claimed that the directive was "in excess of or without jurisdiction" and constitutes a wastage of public funds. It was proved, however, that the petition was based on a Press Release by the Malacañang Press Office. On the other hand, the directive itself commanded the burning of those confiscated "blue seal" cigarettes in those cases where their destruction was allowed by law. The respondents proved that section 2608, Tariff and Customs Code, permitted the destruction of articles that constituted a menace to public health. In the case of the confiscated cigarettes, a Condemnation Committee of the Bureau of Customs certified that they were unfit for sale or use. On this basis, the Supreme Court found that the burning accorded with the procedure permitted by section 2608, Tariff and Customs Code.

VII. REFUND RIGHTS OF TAXPAYERS

A. *Prescription — taxes legally paid*

Sections 306 and 309, Tax Code, embody the refund rights of a taxpayer for taxes illegally or erroneously paid. Section 306 requires that before a court suit for refund could be initiated, the taxpayer must first file a claim with the Commissioner of Internal Revenue, regardless of whether or not payment was made under protest or duress. Such suit must be brought within

114 See note 96, *supra*.
115 G.R. No. 22730, May 24, 1967.

two years from date of payment. Section 309 limits the power of the Commissioner to make refunds or tax credits of taxes erroneously or illegally paid to those made in writing and within two years from date of payment. The Supreme Court, in the case of *Muller & Phipps (Manila) Ltd. v. Collector of Internal Revenue,*[116] held that section 306 applied only to actions to recover taxes that had been erroneously or illegally collected and not to those where the tax had not been erroneously or illegally collected, as when due to a supervening circumstance, the taxpayer subsequently became entitled to a partial refund of taxes previously paid. This was the state of the law until last year when the Supreme Court decided the case of *Commissioner of Internal Revenue v. Insular Lumber Co.*[117]

That case involved the refund of 25% of the specific tax on manufactured oils purchased and used by miners or forest concessionaires in their operations, a right granted under the proviso of section 5, Rep. Act No. 1435. Taxpayer is a forest concessionaire engaged in logging operations. In 1958, it purchased manufactured oils and fuels that it used in its logging operations also in that year. Almost three years later, or on Feb. 23, 1961, taxpayer filed its refund claim based on section 5, Rep. Act No. 1435. The same was denied by the Commissioner of Internal Revenue on the ground that it was filed beyond the two-year prescriptive period provided in sections 306 and 309, Tax Code. Taxpayer appealed to the Tax Court on Feb. 17, 1962, which reversed the decision of the Commissioner. Hence this appeal to the Supreme Court.

While the Government contended that the two-year prescriptive period provided in sections 306 and 309, Tax Code has set in to defeat the claim, taxpayer contended that those provisions applied only to taxes erroneously or illegally paid, citing the case of *Muller & Phipps,*[118] which the tax being claimed was not.

The Supreme Court modified the rule in Muller & Phipps and held that the right to the refund had prescribed for being filed beyond the two year period provided in sections 306 and 309, Tax Code. It stated that these two sections were "intended to govern all kinds of refunds of Internal Revenue taxes — those taxes im-

116 103 Phil. 145 (1958).
117 G.R. No. 24221, December 11, 1967.
118 See note 116, *supra*.

posed and collected pursuant to the National Internal Revenue Code." Supporting this conclusion are these premises:

1) In the case of *Guagua Electric Light Plant Co. v. Collector of Internal Revenue*[119] cited in *Gonzales v. C.T.A.*,[120] the Supreme Court stated that section 306, Tax Code "is mandatory, is not subject to qualification, and, hence, it applies regardless of the conditions under which payment had been made". To hold that the refund pursuant to section 5, Rep. Act No. 1435 is beyond the scope of sections 306 and 309, Tax Code, "is to thwart the aforesaid intention and spirit underlying said provisions";

2) There are other taxes in the Tax Code initially collected legally, but refundable subsequently upon the happening of a supervening cause. Thus,

a. Sec. 146 grants refund of specific tax on negative films, unprinted positive films and reversal films of 16mm or less in amateur photography;
b. Sec. 182(B)(2), 2d par., amended by R.A. 1856, allows refund of occupation tax paid in excess of the rates in effect prior to Jan. 1, 1957;
c. Sec. 53(2)(d) authorizes refund of excess tax withheld at source over the tax due in the income tax return;

All these refunds must be made within the two-year period provided in section 309, Tax Code;

3) Placing refund right of taxes legally or correctly paid beyond the two-year period would make it fall under the prescriptive period of 10 years pursuant to paragraph 2, article 1144, Civil Code. Such effect would handicap the powers of the Bureau of Internal Revenue to verify because section 337, Tax Code, requires taxpayers to keep their records only for five years; and

4) Tax policy demands an early and expeditious tax adjustment so as not to impair the smooth functioning of governmental machinery, which would otherwise result from the uncertainty caused by the controversy.

The Supreme Court laid down the rule, however, that with respect to taxes legally or correctly paid, the two-year period is reckoned not from the date of payment, but from the date of the supervening cause giving rise to the refund. In the instant case, it is the date of use of the oils and fuels from which the two-year period is counted.

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119 G.R. No. 14421, April 29, 1961, 59 O.G. 4207 (April, 1963).
120 G.R. Nos. 14532-33, May 26, 1965.

This decision was followed shortly in the case of *BIR v. Victorias Milling Co., Inc.,*[121] where the Supreme Court also observed that the administrative claim and subsequent appeal to the Tax Court must both be filed within the two-year period.

B. *Parity rights of U.S. nationals*

Rep. Act No. 1435, just discussed, under section 1 thereof, also granted to Filipino citizens a 50% refund of specific tax on manufactured oils and fuels purchased and used in aviation (or agriculture), during the period from June 18, 1952 to June 18, 1957. Foreigners also enjoyed the right if the law of their country granted the same to Filipino citizens. Could this right be claimed by an American citizen who used oil and fuel in his air transportation business on the basis of the parity rights granted to United States citizens and corporations in the Ordinance appended to the Philippine Constitution? The Supreme Court answered "no" in the case of *Comm. of Internal Revenue v. A.D. Guerrero,* special administrator of the estate of Paul I. Gunn.[122] During his lifetime, Paul I. Gunn, an American national, operated air transportation business in the Philippines. During the period covered by the refund provision of section 142, Tax Code, as amended by section 1, Rep. Act No. 1435, Gunn used aviation oil and fuel in his air transportation business on which the corresponding specific tax imposed under section 142, Tax Code, had been paid. His estate filed this claim for refund on the ground that, under the Ordinance appended to the Constitution, Gunn "was entitled to the same rights and privileges as Filipino citizens operating public utilities, including privileges in the matter of taxation." The Commissioner of Internal Revenue denied the claim for partial exemption from the gasoline tax was not included under the terms of the Ordinance; moreover, there was no showing that the United States granted similar exemption to Filipino citizens. The Court of Tax Appeals upheld the taxpayer and directed the refund. Hence this appeal to the Supreme Court.

The Supreme Court, as indicated above, reversed the lower court, on the well-entrenched doctrine that exemption statutes are construed strictly against the taxpayer; that "for a tax

[121] G.R. No. 24108, January 3, 1968.
[122] G.R. No. 20942, September 22, 1967.

exemption to exist, it must be so categorically declared in words that admit of no doubt." Tested by this rule, followed with "undeviating rigidity in the Philippines", in the language of Justice Fernando, from 1906 in *Roman Catholic Church v. Hastings,*[123] to 1966 in *Esso Standard Eastern, Inc. v. Acting Commissioner of Customs*[124] the Ordinance appended to the Constitution contained no language applicable to tax refund or exemption. Said the Court:

> "Its (the Ordinance's) terms are clear. Standing alone, without any franchise to supply that omission, it affords no warrant for the claim here made."

The Supreme Court also used the historical approach to arrive at the same conclusion — that nothing in the history of the Ordinance justifies the view that tax refund or exemption of U.S. citizens or corporations impelled its introduction. Said the Court:

> "In view of the equally fundamental postulate that legal concepts imperatively calling for application cannot be ignored, however, it follows that tax exemption to Americans or to business owned or controlled directly or indirectly by American citizens, based solely on the language of the Ordinance, cannot be allowed. There is nothing in its history that calls for a different view. Had the parties been of a different mind, they would have employed words indicative of such intention. What was not there included, whether by purpose or inadvertence, cannot be judicially supplied."

Another consideration that influenced the court was the temporary character of the Ordinance which allowed operation of public utilities to Americans, an exception to the plain intent of the Constitution to limit operation of public utilities to Filipino citizens and corporations. The view that the Ordinance granted tax refund or exemption to United States citizens or corporations "would trench further on the plain constitutional mandate to limit the operation of public utilities to Filipino hands."

Summarizing why it denied the refund claim, and reversed the lower court, the Supreme Court merely abided by "what the controlling precedents require, namely that tax exemption is not to be presumed and that if granted, it is to be most strictly construed. No such grant was apparent on the face of the Ordinance. No such grant could be implied from its history, much less from its transitory character."

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[123] 5 Phil. 701 (1906).
[124] G.R. No. 21841, October 28, 1966.

C. *Interest on refund — arbitrariness*

Though not expressly provided for in the Tax Code, it is now established by the cases that refund of taxes ordered by the courts could earn interest at the legal rate.[125] The rule, however, has been applied quite strictly against imposition of the interest, and only when the assessment or collection by the BIR had been attended with arbitrariness.[126] 1967 enriches this subject with the decision of the *Supreme Court in Commissioner v. Victorias Milling Co.*[127] There, taxpayer, which secured refund of advance sales tax collected on its importation of sugar bags (to be used as containers of its sugar), insisted that the Government should pay interest on the refunded amount. Its theory was that the collection of the sales tax was attended with arbitrariness because a previous ruling exempted such importations. The Supreme Court rejected the contention and denied payment of interest by the Government, as follows:

> ". . . . The mere fact of the reversal of a ruling previously rendered is not *per se* evidence of arbitrariness; neither is the fact that the administrative ruling is found by the courts not in accordance with law."

Then the Court defined "arbitrariness" in this language:

> ". . . Arbitrariness presupposes inexcusable or obstinate disregard of legal provisions, which, in this case, we do not think exists, the Commissioner's holding being to some extent, plausible on the strict letter of the law."

VIII. SUPREME COURT REVIEW OF TAX COURT CASES

A. *Findings of Fact*

It is now a well-settled rule that the Supreme Court is bound by the findings of fact made by the Court of Tax Appeals, and that only questions of law are open to it for determination. This was reiterated in 1967 by the Court in the case of *Balbas v. Domingo*[128] citing earlier cases.[129] In the case of *Republic of the*

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[125] Carcar Electric & Ice Plant Co., Inc. v. Collector of Internal Revenue, 100 Phil. 50 (1956); Commissioner of Customs v. Asturias Sugar Central, see note 28, *supra.*

[126] Collector of Internal Revenue v. Prieto, G.R. No. 11976, September 26, 1961; Commissioner of Customs v. Asturias Sugar Central, see note 28, *supra.*

[127] G.R. Nos. 24769 & 24779, February 25, 1967.

[128] G.R. No. 19804, Oct. 23, 1967.

[129] Sanchez v. Commissioner of Customs, 102 Phil. 37 (1957); Castro v. Collector of Internal Revenue, G.R. No. 12174, April 26, 1962; Commissioner v. Priscila Estate, Inc., G.R. No. 18282, May 29, 1964, Philippine Guaranty v. Commissioner of Internal Revenue, G.R. No. 22074, Sept. 6, 1965.

Philippines v. Razon[130] the Court again categorically asserted that the findings of fact made by the lower court, namely, that the alien taxpayer was a nonresident alien not engaged in trade or business here, was not reviewable by it, as long as supported by substantial evidence. We quoted at length the language of Mr. Justice Fernando in the case of *Alhambra Cigar and Cigarette Mfg. Co. v. Collector*[131] on this point for it recognizes the "expertise" of the Court of Tax Appeals on the subject of taxation whose findings of fact should not be lightly set aside.

B. *Only matters litigated below are appealable*

Another well-known rule is that only those matters litigated in the lower court are appealable to the Supreme Court. This is illustrated in the case of *Plaridel Surety & Insurance Co. v. Commissioner.*[132] In that case, Plaridel, as surety, was required to pay to the creditor of its principal the total sum of ₱44,490, of which ₱36,600 was the principal sum stipulated in the performance bond posted by Plaridel and ₱10,000 as interest that had accrued. In the filing of its income tax return, Plaridel deducted the entire amount of ₱44,490 as loss. The same was disallowed by the Commissioner of Internal Revenue and appealed by the taxpayer to the Court of Tax Appeals. As already indicated above, the lower court affirmed the disallowance of the loss deduction.

In its appeal to the Supreme Court, Plaridel, for the first time claimed the deduction of the ₱10,000 as interest expense. The Court correctly denied the deduction of said interest, stating that the "alleged interest deduction not having been properly litigated as an issue before the Tax Court, it is now too late to raise and assert it before this Court."[133]

IX. LOCAL TAXATION

It is a principle long established and widely accepted as a textbook rule that local governments do not have inherent power to tax; that whatever such power they possess, is expressly granted by the national legislature. In the past, the enabling acts passed by the legislature did not give municipalities and cities plenary powers to tax. Our jurisprudence on this subject

[130] G.R. No. 17462, May 24, 1967.

[131] *Supra*, note 11.

[132] *Supra*, note 21.

[133] In this connection, see also Cebu Portland Cement Co. resolution of December 29, 1967 (mining tax basis).

therefore has evolved the familiar canon that the local power to tax is construed *strictissimi juris* against the tax, and on this rock many tax ordinances had floundered.

The Congress, however, motivated by a new philosophy and driven by a new wave — that of local autonomy and decentralization — enacted Rep. Act No. 2264, effective June 19, 1959. Compared to earlier grants, this statute gave broad powers of taxation to municipalities, and more so to cities. Congress even provided for liberal rules of interpretation to favor existence of a doubted power in favor of the city or municipality.[134] Broad, indeed are the powers of taxation granted so as to render obsolete some traditional doctrines found in the cases. Nonetheless, the rule is still true that the power to tax exercised by a municipality or city is valid only if within the scope of R.A. 2264. The Congress, as it were, merely enlarged the traditional limits of the enabling act, but the limits are still there. This is seen from the 1967 cases decided by the Supreme Court.

A. *Grant of Taxing Power*

Rep. Act No. 2264, section 2, grants to cities, municipalities and municipal districts power:

1) to impose municipal license taxes or fees upon persons engaged in any occupation or business or exercising privileges therein;
2) to collect fees and charges for services rendered by them;
3) to regulate and impose reasonable fees for services rendered in connection with any business, profession or occupation conducted therein; and otherwise
4) to levy for public purposes, just and uniform taxes.

They are prohibited from imposing some 12 enumerated taxes. Municipalities and municipal districts are additionally prohibited from imposing any percentage tax on sales or other taxes based on sales, or impose taxes on articles already subject to the specific tax under the National Internal Revenue Code. However, they may tax gasoline. With these provisions in mind, the City of Iloilo passed an ordinance imposing a tax of 1/2% of contract price on the sale of real property and made the presentation of the official receipt of payment thereof as a requirement for registering the land. This tax was challenged in the case of *Hodges v. Mun. Board of the City of Iloilo*,[135] on the theory that

[134] Rep. Act No. 2264, sec. 2 (1959).
[135] G.R. No. 18276, Jan. 12, 1967.

it was not authorized by the corporate powers of the City. The Supreme Court disagreed with the petitioner and held that the Ordinance was within the power of the city. Said the Court:

> "2. No special difficulty attends the resolution of the main issue. Heretofore, we have announced the doctrine that the grant of the power to tax to chartered cities under section 2 of the Local Autonomy Act is sufficiently plenary to cover '*everything*, excepting those which are mentioned' therein, subject only to the limitation that the tax so levied is for 'public purposes, just and uniform' (Nin Bay Mining Co. v. Mun. of Roxas, Province of Palawan, G.R. No. 20125, July 20, 1965)"

The Supreme Court observed that this case is on all fours with an earlier case, bearing the same title[186] involving a city tax imposed on the sale of second-hand motor vehicles. The Supreme Court also upheld the tax in that case as coming within the grant of section 2, Rep. Act No. 2264, and not included in the prohibited taxes which a city cannot impose.

This was followed in the case of *Ormoc Sugar Co., Inc. v. Mun. Board of the City of Ormoc.*[187] The City of Ormoc passed an ordinance imposing a tax on the production of centrifugal sugar in the City. The tax was challenged in a petition for declaratory relief as being ultra vires and in restraint of trade. The Supreme Court sustained the tax as within the competence of the City to impose under the Local Autonomy Act. The Court observed that under Rep. Act No. 2264, "the sphere of autonomy of a chartered city in the enactment of taxing measures has been considerably enlarged" and cited with approval its opinion in the Hodges case.[188]

B. *Implied power not to contravene general law.* —

In the Hodges case discussed above, reference is made to the requirement that presentation of the official receipt of payment of the city tax was made a condition for registering the land subject of the sale. The petitioner objected to the requirement as a condition not otherwise called for by general statutory law. To that extent, said the petitioner, the ordinance amended the statute, an act clearly outside its competence. The City argued that it was a means of enforcement of the tax, and therefore implied from a power expressly granted.

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[186] G.R. No. 18129, January 31, 1963.
[187] G.R. No. 24322, July 21, 1967.
[188] G.R. No. 18276, Jan. 12, 1967.

The Supreme Court agreed that the Ordinance imposed an additional condition for the registration of land by the Register of Deeds, not required by the Land Registration Act. It therefore struck down the requirement as ultra vires.

In the earlier case of Hodges, also cited above, a similar requirement for the registration of motor vehicles was sustained as within the power of the City to require, being implied in its power to impose the approved tax. In the 1967 Hodges case, the Supreme Court declared that the earlier Hodges case was deemed modified to the extent it was in conflict with the later decision.

C. *Challenging the local tax*

1. Power of Secretary of Finance

Section 2, Rep. Act No. 2264, provides that the Secretary of Finance has authority to suspend effectivity of a tax ordinance within 120 days from passage, if, in his opinion, the same is unjust, excessive, oppressive or confiscatory. In the Hodges case, the respondents-appellants contended that the court *a quo* lacked jurisdiction to entertain the declaratory suit because the petitioner has not exhausted his administrative remedies, particularly, he did not appeal to the Secretary of Finance.

The Supreme Court dismissed the contention, for

a. The foregoing authority of the Secretary is limited to the grounds enumerated. In the instant case, petitioner did not question the tax on those grounds, but on the ground that it was ultra vires. This is a purely legal question and no administrative relief would have been possible;

b. Assuming that the matter was within the power of the Secretary, there is nothing in section 2, Rep. Act No. 2264 which provides that appealing to the Secretary is mandatory and a prerequisite for a court suit. Therefore, the doctrine of non-exhaustion of administrative remedies does not apply. It applies only when "there is an express legal provision requiring such administrative step as a condition precedent to taking action in court.[189] Hence, the Supreme Court sustained jurisdiction of the lower court.

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[189] Azuelo v. Arnaldo, G.R. No. 15144, May 16, 1960, 58 O.G. 4738, 4740 (June, 1962).

2. Burial taxes ultra vires

In the case of *Policarpio Viray v. City of Caloocan,*[140] the Municipal Board of Caloocan imposed a tax for burying in private cemeteries in Caloocan cadavers exhumed from other places. Petitioner paid the tax for transferring to Caloocan the cadaver of a relative. He then challenged the tax as ultra vires. The City contended that the Ordinance was a valid exercise of its legislative power under Rep. Act No. 2264 and under its police power.

The Supreme Court agreed that the Ordinance was ultra vires and declared it null and void, for

a. While under its police power, the City may regulate cemeteries, such power does not justify the imposition of burial or transfer tax on cadavers removed from places outside, and at the same time not imposing it on cadavers exhumed from within the city and re-buried;

b. It would not fall under Rep. Act No. 2264, Sec. 2, for persons merely burying a cadaver in a private cemetery are not engaged in an occupation or business or exercise of a privilege, whereas, Rep. Act No. 2264 authorizes imposition of a tax or a fee only on persons engaged in any occupation or business or exercising a privilege.

This case illustrates the general proposition that the tax must satisfy the definition of the power to tax made in section 2, Rep. Act No. 2264.

3. Tax in aid of police power

The case of *Ermita-Malate Hotel and Motel Operators Association, Inc., v. Mayor of Manila,*[141] points out the difficulties of challenging taxes imposed in aid of the police power of the state. That case involved an ordinance of the city of Manila regulating the operation of hotels and motels to curb rising immorality. As a device to carry out its objectives, the Ordinance increased the license fee of hotels and motels by 150% and 200% respectively. Other provisions required detailed registration and other stringent requirements. The petitioners attacked the Ordinance as arbitrary and oppressive and violative of the due process clause of the Constitution. Their position was upheld in the court below, hence this appeal to the Supreme Court.

[140] G.R. No. 23118, July 26, 1967.
[141] G.R. No. 24693, July 31, 1967.

Stressing that the Ordinance was enacted in the exercise of the city's police power, the Supreme Court reversed the Court of First Instance and declared the Ordinance valid. The Court observed the lack of evidence to show that the Ordinance deserved to be declared null and void. On this point, the Court emphasized the doctrine that the ordinance enjoyed a presumption of validity and admonished, as Justice Malcolm did in *U.S. v. Salaveria,*[142] that "the action of the elected representatives of the people cannot be lightly set aside."

Justifying the rates of license fees imposed, the Supreme Court pointed to the wider discretion enjoyed in fixing rates of non-useful occupations compared to useful occupations. Said the Court:

> "Admittedly there was a decided increase of the annual license fees provided for in the challenged ordinance for both hotels and motels . . . It has been settled law, however, as far back as 1922 that municipal license fees could be classified into those imposed for regulating occupations or regular enterprises, for the regulation or restriction of non-useful occupations or enterprises and for revenue purposes only. As was explained more in detail in the above Cu Unjieng case:
>
>> '2. Licenses for non-useful occupations are also incidental to the police power and the right to exact a fee may be implied from the power to license and regulate, but in fixing amount of the license fees municipal corporations are allowed a much wider discretion in this class of cases than in the former, and aside from applying the well-known legal principle that municipal ordinances must not be unreasonable, oppressive, or tyrannical, courts have, as a general rule, declined to interfere with such discretion.'
>
> "Moreover, in the equally leading case of Lutz v. Araneta, this Court affirmed the doctrine earlier announced by the American Supreme Court that taxation may be made to implement the state's police power."

Continuing to answer the other objections raised against the Ordinance, the Supreme Court concluded as stated above that regulating motels and hotels came within the police power of the city and its exercise in the Ordinance had not been shown to transgress the constitutional safeguards.

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[142] 39 Phil. 102 (1918).