Title:
Commissioner of Internal Revenue vs. Priscila Estate, Inc. and the Court of Tax Appeals

Facts:
Priscila Estate, Inc., a domestic corporation engaged in real estate leasing, filed its income tax returns for 1949, 1950, and 1951. On June 13, 1952, it amended the 1951 return and paid the corresponding assessment. On September 13, 1952, Priscila Estate claimed a P4,941.00 refund for the 1950 tax year, arguing it overpaid by deducting P6,013.85 instead of P39,673.25 for a lot and building sale loss. The Commissioner of Internal Revenue (CIR) granted a P1,443.00 tax credit for 1950 but assessed deficiency taxes for 1949 and 1951 on November 3, 1953. Priscila Estate contested these assessments and filed suit with the Court of Tax Appeals (CTA) after the CIR refused reconsideration. The CTA ruled in favor of Priscila Estate, leading to the CIR's Supreme Court appeal.

Issues:
1. Should the cost of a demolished "barong-barong" be deducted from gross income or added to the new building's cost?
2. What is the proper basis for calculating depreciation for Building Priscila No. 3?
3. Were the rates of depreciation applied by the tax court to various properties accurate?
4. Is the claim for a refund barred by the prescriptive period under Section 306 of the Internal Revenue Code?

Court's Decision:
1. **Regarding the "barong-barong"**: The Supreme Court upheld the CTA's decision that the cost of the demolished building should be deducted from gross income since its demolition was necessitated by external factors, not the corporation's volition.
2. **Building Priscila No. 3's depreciation**: The Court agreed with the CTA that the basis for depreciation should be the construction cost (P110,600.00), not the lower assessed value, in light of the factual context and the corporation's obligations to the building's vendors.
3. **Rates of depreciation**: Since the CIR did not prove the CTA's depreciation rates and basis for various properties to be arbitrary or an abuse of discretion, the Supreme Court found no reason to disturb the CTA's findings.
4. **Prescriptive period for the refund claim**: The Court found the CIR's claim of prescription untenable because he failed to plead it as a defense in his response to the lawsuit, thereby waiving such defense.

Doctrine:
– The cost of a demolished property that is replaced due to external requirements rather than the owner’s choice can be deducted from gross income.
– The basis for calculating depreciation of a property acquired in exchange for shares of stock should reflect the actual corporate investment, including obligations to vendors.
– The prescription defense must be explicitly pleaded; failure to do so results in its waiver.

Class Notes:
– Deductions from Gross Income: Costs associated with involuntary demolition are deductible.
– Calculation of Depreciation: The basis should reflect actual investment and obligations, not merely assessed value.
– Prescription in Tax Refunds: To invoke prescription as a defense against a tax refund claim, it must be pleaded specifically; otherwise, it is considered waived.

Historical Background:
This case highlights the intricacies of tax law, especially regarding deductions, depreciation, and the statute of limitations for claiming tax refunds. It underscores the importance of the factual context in tax disputes, the procedural requirements for legal defenses, and the judiciary’s role in resolving such disputes. The decision reinforces the principle that tax law interpretations must consider both the taxpayers’ intentions and obligations.