

### Title:

Commissioner of Internal Revenue vs. Court of Tax Appeals and Smith Kline & French Overseas Co. (Philippine Branch)

### Facts:

Smith Kline & French Overseas Company, a multinational pharmaceutical firm from Philadelphia, Pennsylvania, operating in the Philippines, filed an original income tax return for 1971 declaring a net taxable income and tax due, including deductions for overhead expenses shared with its head office. Upon receiving a certification from Peat, Marwick, Mitchell, and Company in October 1972, Smith Kline realized an underdeduction of home office overhead expenses for the year ended December 31, 1971. This led to the filing of an amended return reflecting an overpayment of tax, for which a refund was claimed. The Commissioner of Internal Revenue did not act on the claim, prompting Smith Kline to file a petition for review with the Court of Tax Appeals (CTA) in April 1974. The CTA ruled in favor of Smith Kline, directing the Commissioner to refund or credit the overpayment, a decision the Commissioner appealed to the Supreme Court.

### Issues:

1. Whether the contract between Smith Kline's Philippine branch and its head office, which fixed a certain amount for overhead expense deductions, can supersede tax laws and regulations allowing for a different amount based on actual computations.
2. Whether Smith Kline is entitled to a refund based on the overdeduction resulting from a subsequent audit that identified a larger share of deductible overhead expenses than initially estimated.

### Court's Decision:

The Supreme Court upheld the decision of the Court of Tax Appeals, affirming that Smith Kline's amended return, reflecting a higher deduction for shared overhead expenses in accordance with tax laws and regulations, was correct. The contract fixing overhead expense deductions could not override the applicable tax laws and regulations dictating the method of computation. The court rejected the Commissioner's argument that the agreement between the branch and the head office was binding over the tax regulations.

### Doctrine:

The Supreme Court reaffirmed the doctrine that contracts between private parties cannot amend or supersede tax laws and regulations. Deductions allowed by the National Internal

Revenue Code and relevant Revenue Regulations are to be computed in accordance with the law, regardless of prior agreements to the contrary between a company's head office and its branches.

### Class Notes:

- **Tax Overpayments and Refunds**: Where a taxpayer files an amended return showing an overpayment due to an earlier underestimation of deductible expenses, they are entitled to claim a refund or credit for the overpayment if substantiated by adequate evidence.
- **Relationship between Contracts and Tax Laws**: Private agreements, including those pertaining to the allocation of expenses between a head office and branch, cannot contravene applicable tax statutes and regulations.
- **Computation of Deductible Expenses**: Under section 37(b) of the Revenue Code and corresponding regulations, certain overhead expenses of a multinational company can be apportioned to its Philippine branch based on the ratio of the branch's gross income to the total gross income worldwide.

### Historical Background:

This case illustrates the tension between contractual agreements among multinational corporate entities regarding internal expense allocation and the sovereign tax regulations of the Philippines. It underscores how the latter prevails in determining tax liabilities and entitlements to refunds, reflecting the principle that tax laws serve public interest and cannot be overridden by private contracts.