

Title: **\*\*ESSO Standard Eastern, Inc. vs. The Commissioner of Internal Revenue\*\***

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### ### Facts:

The legal conflict between ESSO Standard Eastern, Inc. (formerly, Standard-Vacuum Oil Company) and the Commissioner of Internal Revenue (CIR) revolves around tax disputes for the fiscal years 1959 and 1960. The cases, numbered CTA No. 1251 and CTA No. 1558, originated from ESSO's claims for refund due to what it considered overpaid income taxes amounting to P102,246.00 for 1959 and P434,234.93 for 1960, respectively.

In CTA Case No. 1251, ESSO deducted expenses related to the drilling and exploration of petroleum concessions from its gross income for 1959, an action later contested by the CIR, who argued these should be capitalized. ESSO also sought refunds for abandoned oil wells ('dry holes') and margin fees paid to the Central Bank for profit remittances to its New York headquarters.

In CTA Case No. 1558, the CIR assessed ESSO a deficiency income tax for 1960 due to disallowed margin fees on profit remittances. ESSO settled under protest and later contested an alleged overpayment on interest regarding this tax deficiency.

The CIR denied all refund claims, maintaining that margin fees were neither taxes nor allowable business expenses under tax law. ESSO's appeals to the Court of Tax Appeals (CTA) were dismissed, leading to the escalation of the case to the Supreme Court.

### ### Issues:

1. Whether the margin fees paid by ESSO to the Central Bank are considered taxes, thereby deductible from ESSO's gross income under tax law provisions.
2. If not considered taxes, whether these margin fees qualify as ordinary and necessary business expenses, hence deductible from gross income.

### ### Court's Decision:

The Supreme Court ruled against ESSO on both issues. Firstly, it determined that the margin fees were not taxes but were imposed by the State under its police power to regulate excessive demands on international reserves. Citing previous cases, the Court emphasized the nature of the margin fee as a measure of exchange control distinct from

taxation intended to generate government revenue.

Secondly, on examining whether margin fees could be deemed necessary and ordinary business expenses, the Court, adhering to the National Internal Revenue Code and jurisprudence on business deductions, concluded that ESSO failed to demonstrate that such expenses were essential and proper for the conduct of its business in the Philippines. The Court opined that the expenses related more to the benefit of ESSO's New York head office rather than its Philippine operations.

### ### Doctrine:

The Supreme Court reiterated that not all corporate expenses could automatically qualify as necessary and ordinary business expenses deductible from gross income. Deductions are a matter of legislative grace, and the burden of proof lies on the taxpayer to justify any claim for such deductions.

### ### Class Notes:

- **Margin Fees:** Not considered taxes; instead, they are regulatory measures under the state's police power.
- **Deductions from Gross Income:** Deductions are a matter of legislative grace. The taxpayer carries the burden of proof to justify the claim.
- **Ordinary and Necessary Business Expenses:** Must be essential and appropriate for the conduct of the taxpayer's business. An expense benefiting another entity, even if related, does not qualify.

### ### Historical Background:

This case provides insight into the complexities of tax law, particularly on the nature of expenses incurred by international companies operating in the Philippines. It highlights the distinction between regulatory fees and taxes, and the stringent criteria for business expense deductions under Philippine tax law.