

**THE COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS.
PHOENIX ASSURANCE CO., LTD., RESPONDENT; PHOENIX
ASSURANCE CO., LTD., PETITIONER VS. COMMISSIONER OF
INTERNAL REVENUE, RESP...**

G. R. Nos. L-19727 and 19903. May 20, 1965

Ponente: BENGZON, J.P., J.

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BENGZON, J.P., J.:

From a judgment of the Court of Tax Appeals in C.T. A. Cases Nos. 305 and 543, consolidated and jointly heard therein, these two appeals were taken. Since they involve the same facts and interrelated issues, the appeals are herein decided together.

Phoenix Assurance Co., Ltd., a foreign insurance corporation organized under the laws of Great Britain, is licensed to do business in the Philippines with head office in London. Through its head office it entered, in London, into worldwide reinsurance treaties with various foreign insurance companies. It agreed to cede a portion of premiums received on original insurances underwritten by its head office, subsidiaries, and branch offices throughout the world, in consideration for assumption by the foreign insurance companies of an equivalent portion of the liability from such original insurances.

Pursuant to such reinsurance treaties, Phoenix Assurance Co., Ltd. ceded portions of the premiums it earned from its underwriting business in the Philippines, as follows:

Year

Amount Ceded

1952

P316,526.75

1953

P246,082.04

1954

P203,384.69

upon which the Commissioner of Internal Revenue, by letter of May 6, 1958, assessed the following withholding tax:

Year

Withholding Tax

1952

P75,966.42

1953

59,059.68

1954

48,812.32

Total

183,838.42

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On April 1, 1951, Phoenix Assurance Co., Ltd. filed its Philippine income tax return for 1950, claiming therein, among others, a deduction of P37,147.04 as net addition to marine insurance reserve equivalent to 40% of the gross marine insurance premiums received during the year. The Commissioner of Internal Revenue disallowed P11,772.57 of such claim for deduction and subsequently assessed against Phoenix Assurance Co., Ltd. the sum of P1,884.00 as deficiency income tax. The disallowance resulted from the fixing by the Commissioner of the net addition to the marine insurance reserve at 100% of the marine insurance premiums received during the last three months of the year. The Commissioner assumed that "ninety and thirty days are approximately the length of time required before shipments reach their destination or before claims are received by the insurance companies.

On April 1, 1953 Phoenix Assurance Co., Ltd. filed its Philippine income tax return for 1952, declaring therein a deduction from gross income of P35,912.25 as part of the head office expenses incurred for its Philippine business, computed at 5% on its gross Philippine income.

On August 30, 1955 it amended its income tax return for 1952 by excluding from its' gross income the amount of P316,526.75 representing reinsurance premiums ceded to foreign reinsurers and further eliminating deductions corresponding to the ceded premiums. The amended return showed an income tax due in the amount of P2,502.00. The Commissioner of Internal Revenue disallowed P15,826.35 of the claimed deduction for head office expenses and assessed a deficiency tax of P5, 667.00 on July 24, 1958.

On April 30, 1954 Phoenix Assurance Co., Ltd. filed its Philippine income tax return for 1953 and claimed therein a deduction from gross income of P33,070.88 as head office expenses allocable to its Philippine business, equivalent to 5% of its gross Philippine income. On August 30, 1955 it amended its 1953 income tax return to exclude from its gross income the amount of P246,082.04 representing reinsurance premiums ceded to foreign reinsurers. At the same time it requested the refund of P23,409.00 as overpaid income tax for 1953. To avoid the prescriptive period provided for in Section 306 of the Tax Code, it filed a petition for review on August 11, 1956

in the Court of Tax Appeals praying for such refund. After verification of the amended income tax return the Commissioner of Internal Revenue disallowed P12,304.10 of the deduction representing head office expenses allocable to Philippine business thereby reducing the refundable amount to P20,180.00.

On April 29, 1955 Phoenix Assurance Co., Ltd. filed Philippine income tax return for 1954 claiming therein, among others, a deduction from gross income of P29,624.75 as head office expenses allocable to its Philippine Business, computed at 5% of its gross Philippine income. It also excluded from its gross income the amount of P203,384.69 representing reinsurance premiums ceded to foreign reinsurers not doing business in the Philippines.

On August 1, 1958 the Bureau of Internal Revenue released the following assessment for deficiency income tax for the years 1952 and 1954 against Phoenix Assurance Co., Ltd.

1952

Net income per audited return

P12,511.61

Unallowable deductions & additional income:

Over-claimed Head Office expenses:

Amount claimed

P35,912.25

Amount allowed

20,085.90

15,826.35

Net income per investigation

P28,337.96

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Tax due thereon

P5,667.00

1954

Net income per audited return

P160,320.21

Unallowable deductions & additional income:

Overclaimed Head Office expenses:

Amount claimed

P29,024.73

Amount allowed

P19,455.50

10,169.23

Net income per investigation

P170,489.44

Tax due thereon

P 39,737.00

Less: amount already assessed

P30,890.00

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DEFICIENCY TAX DUE

P2,847.00

The above assessment resulted from the disallowance of a portion of the deduction claimed by Phoenix Assurance Co., Ltd. as head office expenses allocable to its business in the Philippines fixed by the Commissioner at 5% of the net Philippine income instead of 5% of the gross Philippine income as claimed in the returns.

Phoenix Assurance Co., Ltd. protested against the aforesaid assessments for withholding tax and deficiency income tax. However, the Commissioner of Internal Revenue denied such protest. Subsequently, Phoenix Assurance Co., Ltd. appealed to the Court of Tax Appeals. In a decision dated February 14, 1962, the Court of Tax Appeals allowed in full the deduction claimed by Phoenix Assurance Co., Ltd. for 1950 as net addition to marine insurance reserve; determined the allowable head office expenses allocable to Philippine business to be 5% of the net income in the Philippines; declared the right of the Commissioner of Internal Revenue to assess deficiency income tax for 1952 to have prescribed; absolved Phoenix Assurance Co., Ltd. from payment of the statutory penalties for non-filing of withholding tax return; and, rendered the following judgment:

"Wherefore, petitioner Phoenix Assurance Company, Ltd., is hereby ordered to pay the Commissioner of Internal Revenue the respective amounts of P75,966.42, P59,059.68 and P48,812.32, as withholding tax for the years 1952, 1953 and 1954, and P2,847.00 as income tax for 1954, or the total sum of P186,685.42 within thirty (30) days from the date his decision become final. Upon the other hand, the respondent Commissioner is ordered to refund to petitioner the sum of P20,180.00 as overpaid income tax for 1953, which sum is to be deducted from the total sum of P186,685.42 due as taxes.

"If any amount of the tax is not paid within the time prescribed above, there shall be collected a surcharge of 5% of the tax unpaid, plus interest at the rate of 1% a month from the date of delinquency to the date of payment, provided that the maximum amount that may be collected as interest shall not exceed the amount corresponding to a period of three (3) years. Without pronouncement as to costs".

Phoenix Assurance Co., Ltd. and the Commissioner of Internal Revenue have appealed to this Court raising the following issues: (1) Whether or not reinsurance premiums ceded to foreign reinsurance not doing business in the Philippines pursuant to reinsurance contracts executed abroad are subject to withholding tax; (2) Whether or not the right of the Commissioner of Internal Revenue to assess deficiency income tax for the year 1952 against Phoenix Assurance Co., Ltd. has prescribed; (3) Whether or not the deduction claimed by Phoenix Assurance Co., Ltd. as net addition to reserve for the year 1950 is excessive; (4) Whether or not the deductions claimed by Phoenix Assurance Co., Ltd. for head office expenses allocable to Philippine business for the years 1952, 1953 and 1954 are excessive.

The question of whether or not reinsurance premiums ceded to foreign reinsurers not doing business in the Philippines pursuant to contracts executed abroad are income from sources within the Philippines subject to withholding tax under Section 53 and 54 of the Tax Code has already been resolved in the affirmative in *British Traders' Insurance Co., Ltd. vs. Commissioner of Internal Revenue*, L-20501, April 30, 1965.[[1]]

We come to the issue of prescription. Phoenix Assurance Co., Ltd. filed its income tax return for 1952 on April 1, 1953 showing a loss of P199,583.93. It amended said return on August 30, 1955 reporting a tax liability of P2,502.00. On July 24, 1958, after examination of the amended return, the Commissioner of Internal Revenue assessed deficiency income tax in the sum of P5,667.00. The Court of Tax Appeals found the right of the Commissioner of Internal Revenue barred by prescription, the same having been exercised more than five years from the date the original return was filed. On the other hand, the Commissioner of Internal Revenue insists that his right to issue the assessment has not prescribed inasmuch as the same was availed of before the 5-year period provided for in Section 331 of the Tax Code expired, counting the running of the period from August 30, 1955, the date when the amended return was filed.

Section 331 of the Tax Code, which limits the right of the Commissioner of Internal Revenue to assess income tax within five years from the filing of the income tax return, states:

"SEC. 331. Period of limitation upon assessment and collection.— Except as provided in the succeeding section, internal-revenue taxes shall be assessed within five years after the return was filed, and no proceeding in court

without assessment for the collection of such taxes shall be begun after the expiration of such period. For the purposes of thin section a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day: Provided, That this limitation shall not apply to cases already investigated prior to the approval of this Code."

The question is: Should the running of the prescriptive period commence from the filing of the original or amended return?

The Court of Tax Appeals ruled that the original return was a complete return containing "information on various items of income and deduction from which respondent may intelligently compute and determine the tax liability of petitioner", hence, the .prescriptive period should be counted from the filing of said original return. On the other hand, the Commissioner of Internal Revenue maintains that:

"* * * the deficiency income tax in question could not possibly be determined, or assessed, on the basis of the original return filed on April 1, 1953, for considering that the declared loss amounted to P199,583.93, the mere disallowance of part of the head office expense could not possibly result in said loss being completely wiped out and Phoenix being liable to deficiency tax. Not until the amended return was filed on August 30, 1955 could the Commissioner assess the deficiency income tax in question."

Accordingly, he would wish to press for the counting of the prescriptive period from the filing of the amended return.

To our mind, the Commissioner's view should be sustained. The changes and alterations embodied in the amended income tax return consisted of the exclusion of reinsurance premiums received from domestic insurance companies by Phoenix Assurance Co., Ltd.'s London head office, reinsurance premiums ceded to foreign reinsurers not doing business in the Philippines and various items of deduction attributable to such excluded reinsurance premiums, thereby substantially modifying the original return. Furthermore, although the deduction for head office expenses allocable to Philippine business, whose disallowance gave rise to the deficiency tax, was claimed also in the original return, the Commissioner could not have possibly determined a deficiency tax thereunder because Phoenix Assurance Co., Ltd. declared a loss of P199,583.93 therein which would have more than offset such disallowance of P15,826.35. Considering that the deficiency assessment was based on the amended return which, as afore-stated, is substantially different from the original return, the period of limitation of the right to issue the same should be counted from the filing of the amended income tax return. From August 30, 1955, when the amended return was filed, to July 24, 1958, when the deficiency assessment was issued, less than five years elapsed. The right of .the Commissioner to assess the deficiency tax on such amended return has not prescribed.

To strengthen our opinion, we believe that to hold otherwise, we would be paving the way for taxpayers to evade the payment of taxes by simply reporting in their original return heavy losses and amending the same more than five years later when the Commissioner of Internal Revenue has lost his authority to assess the proper tax thereunder. The object of the Tax Code is to impose taxes for the needs of the Government, not to enhance tax avoidance to its prejudice.

We next consider Phoenix Assurance Co., Ltd.'s claim for deduction of P37,147.04 for 1950 representing net addition to reserve computed at 40% of the marine insurance premiums received during the year. Treating said deduction to be excessive, the Commissioner of Internal Revenue reduced the same to P25,374.47 which is equivalent to 100% of all marine insurance premiums received during the last three months of the year.

Paragraph (a) of Section 32 of the Tax Code states:

"SEC. 32. Special provisions regarding income and deductions of insurance companies, whether domestic or

foreign.—(a) Special deduction allowed to insurance companies.—In the case of insurance companies, whether domestic or foreign, the net additions, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts may be deducted from, their grogs income."

Section 186 of the Insurance Law requires the setting up of reserves for liability on marine insurance:

"Section 186. " * * * Provided, That for marine risks the insuring company shall be required to charge as the liability for reinsurance fifty per centum of the premiums written in the policies upon yearly risks, and the full premiums written in the policies upon alt other marine risks not terminated." (Italics supplied.)

The reserve required for marine insurance is determined on two bases: 50% of premiums under policies on yearly risks and 100 % of premiums under policies of marine risks not terminated during the year.[*] Section 32 (a) of the Tax Code quoted above allows the full amount of such reserve to be deducted from gross income.

It may be noteworthy to observe that the formulas for determining the marine reserve employed by Phoenix Assurance Co., Ltd. and the Commissioner of Internal Revenue—40% of premiums received during the year and 100% of premiums received during the last three months of the year, respectively—do not comply with Section 186. Said determinations run short of the requirement. For purposes of the Insurance Law, this Court therefore cannot countenance the same. The reserve called for in Section 186 is a safeguard to the general public and should be strictly followed not only because it is an express provision but also as a matter of public policy. However, for income tax purposes a taxpayer is free to deduct from its gross income a lesser amount, or not to claim any deduction at all. What is prohibited by the income tax law is to claim a deduction beyond the amount authorized therein.

Phoenix Assurance Co., Ltd/s claim for deduction of P37,147.01 being less than the amount required in Section 186 of the Insurance Law, the same cannot be and is not excessive, and should therefore be fully allowed.

We come now to the controversy on the taxpayer's claim for deduction on head office expenses incurred during 1952, 1953 and 1954 allocable to its Philippine business computed at 5% on its gross income in the Philippines. The Commissioner of Internal Revenue redetermined such deduction at 5% on Phoenix Assurance Co., Ltd.'s net income thereby partially disallowing the latter's claim. The parties are agreed as to the percentage—5%—but differ as to the basis of computation. Phoenix Assurance Co., Ltd. insists that the 5% head office expenses be determined from the gross income, while the Commissioner wants the computation to be made on the net income. What, therefore, needs to be resolved is: Should the 5% be computed on the gross or net income?

The record shows that the gross income of Phoenix Assurance Co., Ltd. consists of income from its Philippic business as well as reinsurance premiums received for its head office in London and reinsurance premiums c to foreign reinsurers. Since the items of income belonging to its Philippine business are not taxable to Philippine branch, they should be excluded in the head office expenses allocable to said Philippine branch. This conclusion finds support in paragraph 2, subsection (a), Section 30 of the Tax Code, quoted hereunder:

"(2) Expenses allowable to non-resident alien individual and foreign corporations.—In thee case of a non-resident alien individual or a foreign corporation, the expenses deductible are the n expenses paid or incurred in carrying on any business or trade conducted within the Philippines exclusively." (Italics supplied.)

Consequently, the deficiency assessments for 1952,1953 and 1954, resulting from partial disallowance of deduction representing head office expenses, are sustained.

Finally, the Commissioner of Internal Revenue assails the dispositive portion of the Tax Court's decision limiting the maximum amount of interest collectible for delinquency to an account corresponding to a period of .throe

years. He contends that since such limitation we incorporated into Section 51 of the Tax Code by Republic Act 2343 which took effect only on June 20, 1959, it must not be applied retroactively on withholding tax for the years 1952, 1953 and 1954.

The imposition of interest on unpaid taxes is one of the statutory penalties for tax delinquency, from the payments of which the Court of Tax Appeals absolved the Phoenix Assurance Co., Ltd. on the equitable ground that the latter's failure to pay the withholding tax was due to the Commissioner's opinion that no withholding tax was due. Consequently, the taxpayer could be liable for the payment of statutory penalties only upon its failure to comply with the Tax Court's judgment rendered on February 14, 1962, after Republic Act 2343 took effect. This part of the ruling of the court ought not to be disturbed.

Wherefore, the decision appealed from is modified. Phoenix Assurance Co., Ltd. is hereby ordered to pay the Commissioner of Internal Revenue the amount of p75,966.42, P59,059.68 and P48,812.32 as withholding tax for the years 1952, 1953 and 1954, respectively, and the sums of P5,667.00 and P2,847.00 as income tax for 1952 and 1954 or a total of P192,352.42. The Commissioner of Internal Revenue is ordered to refund to Phoenix Assurance Co., Ltd. the amount of P20,180.00 as overpaid income tax for 1953, which should be deducted from the amount of P192,352.42.

If the amount of P192,352.42 or a portion thereof is not paid within thirty (30) days from the date this judgment becomes final, there shall be collected a surcharge and interest as provided for in Section 51 (e) (2) of the Tax Code. No costs. It is so ordered.

Bengzon, C. J., Bautista Angelo, Concepcion, Reyes, J. B. L., Barrera, Paredes, Dizon, Regala, Makalintal and Zaldivar, JJ., concur.

[1] See also *Alexander Howden & Co., Ltd. vs. Commissioner of Internal Revenue*, L-19392, April 14, 1965; *Philippine Guaranty Co., Inc. vs. Commissioner of Internal Revenue*, L-22074, April 30, 1965.

[*] See *Maryland Casualty Co. vs. U.S.*, 251 U.S. 342 64, L. ed. 297; *State Farm Mutual Automotive Insurance Company vs. Duel*, 324 U.S. 154, 89 L ed. 812; *Insurance Company of North America vs. McCoach*, D. C. Pa, 218 F. 905; *City of Newark vs. State Board of Equalization of Taxes*, 79 A. 343, 81 N. J. L. 416; interpreting charges for liability on insurance contracts as reserves.

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