

COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS. V. E. LEDNICKY AND MARIA VALERO LEDNICKY, RESPONDENTS.

G.R. Nos. 18169, 18286, and 21434. July 31, 1964

Ponente: REYES, J.B.L., J.

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REYES, J.B.L., J.:

The above-captioned cases were elevated to this Court under separate petitions by the Commissioner for review of the corresponding decisions of the Court of Tax Appeals. Since these cases involve the same parties and issues akin to each case presented, they are herein decided jointly.

The respondents, V. E. Lednicky and Maria Valero Lednicky, are husband and wife, respectively, both American citizens residing in the Philippines, and have derived all their income from Philippine sources for the taxable years under question.

In compliance with local law, the aforesaid respondents, on 27 March 1957, filed their income tax return for 1956, reporting therein a gross income of P1,017,287.65 and a net income of P733,809.44 on which the amount of P317,395.41 was assessed after deducting P4,805.59 as withholding tax.

Pursuant to the petitioner's assessment notice, the respondents paid the total amount of P326,247.41, inclusive of the withheld taxes, on 15 April 1957.

On 17 March 1959, the respondents Lednickys filed an amended income tax return for 1956. The amendment consists in a claimed deduction of P205,939.24 paid in 1956 to the United States government as federal income tax for 1956. Simultaneously with the filing of the amended return, the respondents requested the refund of PI 12,437.90.

When the petitioner Commissioner of Internal Revenue failed to answer the claim for refund, the respondents filed their petition with the tax court on 11 April 1959 as CTA Case No. 646, which is now G. R. No. L-18286 in the Supreme Court.

G.R. No. L-18169 (formerly CTA Case No. 570) is also a claim for refund in the amount of F150,269.00, as alleged overpaid income tax for 1955, the facts of which are as follows:

On 28 February 1956, the same respondents-spouses filed their domestic income tax return for 1955, reporting a gross income of P1,771,124.63 and a net income of P1,052,550.67. On 19 April 1956, they filed an amended income tax return, the amendment upon the original being a lesser net income of P1,012,554.51, and, on the basis of this amended return, they paid P570,252.00, inclusive of withholding taxes. After audit, the petitioner determined a deficiency of P16,116.00, which amount the respondents paid on 5 December 1956.

Back in 1955, however, the Lednickys filed with the U.S. Internal Revenue Agent in Manila their Federal income tax return for the years 1947, 1951, 1952, 1953 and 1954 on income from Philippine sources on a cash basis. Payment of these federal income taxes, including penalties and delinquency interest in the amount of

\$264,588.82, were made in 1955 to the U. S. Director of Internal Revenue, Baltimore, Maryland, through the National City Bank of New York, Manila Branch. Exchange and bank charges in remitting payment totaled P4,143.91.

On 11 August 1958 the said respondents amended their Philippines income tax return for 1955 to include the following deductions:

U.S. Federal income taxes P471.867.32

Interest accrued up to May 15, 1955 40,333.92

Exchange and bank Charges 4,143.91

Total

P516,345.15

and therewith filed a claim for refund of the sum of P166,384.00, which was later reduced to P150,269.00.

The respondents Lednicky brought suit in the Tax Court, which was docketed therein as CTA Case No. 570.

In G. R. No. 21434 (CTA Case No. 173, the facts are similar but refer to respondents Lednickys income tax returns for 1957, filed on February 28, 1958, and for which respondents paid a total sum of P196,799.65. In 1959, they filed an amended return for 1957, claiming deduction of P190,755.80, representing taxes paid to the U.S. Government on income derived wholly from Philippine sources. On the strength thereof, respondents seek refund of P90,520.75 as overpayment. The tax Court again decided for respondents.

The common issue in all three cases, and one that is of first impression in this jurisdiction, is whether a citizen of the United States residing in the Philippines, who derives income wholly from sources within the Republic of the Philippines, may deduct from his gross income the income taxes he has paid to the United States government for the taxable year on the strength of section 30 (c-1) of the Philippine Internal Revenue Code, reading as follows:

"Sec. 30. Deduction from gross income.—In computing net income there shall be allowed as deductions—

"(a) * * *

(b) * * *

(c) Taxes:

"(1) In general.—Taxes paid or accrued within the taxable year, except—

"(A) The income tax provided for under this Title;

"(B) Income, war-profits, and excess profits taxes imposed by the authority of any foreign country; but this deduction shall be allowed in the case of a taxpayer who does not signify in his return his desire to have to any extent the benefits of paragraph (3) of this subsection (relating to credit for taxes of foreign countries);

"(C) Estate, inheritance and gift taxes; and

"(D) Taxes assessed against local benefits of a kind tending to increase the value of the property assessed."
(Italics supplied)

The Tax Court hold that they may be deducted because of the undenied fact that the respondent spouses did not "signify" in their income tax returns a desire to avail themselves of the benefits of paragraph 3 (B) of the subsection, which reads:

"Par. (c) (3) Credits against tax for taxes of foreign countries.— If the taxpayer signifies in his return his desire to have the benefits of this paragraph, the tax imposed by this Title shall be credited with—

(A) * * * * *

(B) Alien resident of the Philippines.—In the case of an alien resident of the Philippines, the amount of any such taxes paid or accrued during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the Philippines residing in such country;"

It is well to note that the tax credit so authorized is limited under paragraph 4 (A and B) of the same subsection, in the following terms:

"Par. (c) (4) Limitation on credit—The amount of the credit taken under this section shall be subject to each of the following limitations:

(A) The amount of the credit in respect to the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources within such country taxable under this Title bears to his entire net income for the same taxable year; and

(B) The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources without the Philippines taxable under this Title bears to his entire net income for the same taxable year."

We agree with appellant Commissioner that the construction and wording of Section 30 (c) (1) (8) of the Internal Revenue Act shows the law's intent that the right to deduct income taxes paid to foreign government from the taxpayer's gross income is given only as an alternative or substitute to his right to claim a tax credit for such foreign income taxes under section 30 (c) (3) and (4); so that unless the alien resident has a right to claim such tax credit if he so chooses, he is precluded from deducting the foreign income taxes from his gross income. For it is obvious that in prescribing that such deduction shall be allowed in the case of a taxpayer who does not signify in his return his desire to have to any extent the benefits of paragraph (3) (relating to credits for taxes paid to foreign countries). the statute assumes that the taxpayer in question also may signify his desire, to claim a tax credit and waive the deduction; otherwise, the foreign taxes would always be deductible, and their mention in the list of non-deductible items in Section 30 (c) might as well have been omitted, or at least expressly limited to taxes on income from sources outside the Philippine Islands.

Had the law intended that foreign income taxes could be deducted from gross income in any event, regardless of the taxpayer's right to claim a tax credit, it is the latter right that should be conditioned upon the taxpayer's waiving the deduction; in which case the right to reduction under subsection (c-1-B) would have been made absolute or unconditional (by omitting foreign taxes from the enumeration of non-deductions), while the right to a tax credit under subsection (c-3) would have been expressly conditioned upon the taxpayer's not claiming any deduction under subsection (c-1). In other words, if the law had been intended to operate as contended by the respondent taxpayers and by the Court of Tax Appeals, section 30 (subsection c-1), instead of providing as at present:

SEC. 30. Deduction from gross income.—In computing net income there shall be allowed as deductions—

(a) * * * * *

(b) * * * * *

"(c) Taxes

"(1) In general.—Taxes paid or accrued within the taxable year, except—

"(A) The income tax provided for under this Title;

"(B) Income, war-profits, and excess profits taxes imposed by the authority of any foreign country; but this deduction shall be allowed in the case of a taxpayer who does not signify, in his return his desire to have to any extent the benefits of paragraph (3) of this subsection (relating to credit for taxes of foreign countries);

"(C) Estate, inheritance and gift taxes; and

"(D) Taxes assessed against local benefits of a kind tending to increase the value of the property assessed."

would have merely provided:

Sec. 30. Deductions from gross income.—In computing net income there shall be allowed as deductions:

"(a) * * * * *

"(b) * * * * *

(c) Taxes paid or accrued within the taxable year, except—

(A) The income tax provided for in this Title;

(B) Omitted or else worked as follows:

Income, war profits and excess profits taxes imposed by authority of any foreign country on income earned within the Philippines if the taxpayer does not claim the benefits under paragraph 3 of this subsection;

(C) Estate, inheritance or gift taxes;

(D) Taxes assessed against local benefits of a kind tending to increase the value of the property assessed.";

while subsection (c-3) would have been made conditional in the following or equivalent terms:

"(3) Credits against tax for taxes of foreign countries.—If the taxpayer has not deducted such taxes from his gross income but signifies in his return his desire to have the benefits of this paragraph, the tax imposed by Title shall be credited with * * * (etc.)."

Petitioners admit in their brief that the purpose of the law is to prevent the taxpayer from claiming twice the benefits of his payment of foreign taxes, by deduction

from gross income (subs. c-1) and by tax credit (subs. c-3). This danger of double credit certainly can not exist if the taxpayer can not claim benefit under either of these headings at his option, so that he must be entitled to a tax credit (respondent taxpayers admittedly are not so entitled because all their income is derived from Philippine sources), or the option to deduct from gross income disappears altogether.

Much stress is laid on the thesis that if the respondent taxpayers are not allowed to deduct the income taxes they are required to pay to the government of the United States, in their return for Philippine income tax, they would be subjected to double taxation. What respondents fail to observe is that double taxation becomes obnoxious only where the taxpayer is taxed twice for the benefit of the same governmental entity (cf. *Manila vs. Interisland Gas Service*, 99 Phil., 847; 52 Off. Gaz. 6579, *Manuf. Life Ins. Co. vs. Meer*, 89 Phil. 357). In the present case, while the taxpayers would have to pay two taxes on the same income, the Philippine government only receives the proceeds of one tax. As between the Philippines, where the income was earned and where the taxpayer is domiciled, and the United States, where that income was not earned and where the taxpayer did not reside, it is

indisputable that justice and equity demand that the tax on the income should accrue to the benefit of the Philippines. Any relief from the alleged double taxation should come from the United States, and not from the Philippines, since the former's right to burden the taxpayer is solely predicated on his citizenship, without contributing to the production of the wealth that is being taxed.

Aside from not conforming to the fundamental doctrine of income taxation that the right of a government to tax income emanates from its partnership in the production of income, by providing the protection, resources, incentives, and proper climate for such production, the interpretation given by the respondents to the revenue law provision in question operates, in its application, to place a resident alien with only domestic sources of income in an equal, if not in a better, position than one who has both domestic and foreign sources of income, a situation which is manifestly unfair and short of logic.

Finally, to allow an alien resident to deduct from his gross income whatever taxes he pays to his own government amounts to conferring on the latter power to reduce the tax income of the Philippine government simply by increasing the tax rates on the alien resident. Everytime the rate of taxation imposed upon an alien resident is increased by his own government, his deduction from Philippine taxes would correspondingly increase, and the proceeds for the Philippines diminished, thereby subordinating our own taxes to those levied by a foreign government. Such a result is incompatible with the status of the Philippines as an independent and sovereign state.

IN VIEW OF THE FOREGOING, the decisions of the Court of Tax Appeals are reversed, and the disallowance of the refunds claimed by the respondents Lednický is affirmed, with costs against said respondents-appellees.

Bengzon, C. J., Padilla, Bautista Angelo, Labrador, Concepcion, Reyes, J. B. L., Regala and Makalintal, JJ., concur.

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