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by respondent Judge on February 21, 1966 is granted. The writ of prohibition sought is denied. Without pronouncement as to costs.

*Reyes, J.B.L. (Acting C.J.), Makalintal, Zaldivar, Sanchez* and *Capistrano, JJ.*, concur.

*Dizon, J.*, in the result.

*Teehankee* and *Barredo, JJ.*, took no part.

*Concepcion C.J.*, and *Ruiz Castro, J.*, are on official leave.

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[G.R. No. L-18840. May 29, 1969]

KUENZLE & STREIFF, INC., petitioner, *vs.* THE COMMISSIONER OF INTERNAL REVENUE, respondent.

SYLLABUS

1. TAXATION; INCOME TAXATION; DEDUCTIBLE EXPENSES; BONUSES TO EMPLOYEES; DEDUCTION NOT ALLOWABLE IN CASE AT BAR.— Where the bonuses to petitioner's top officials were paid in spite of the fact that according to its income tax returns for the years 1953, 1954, and 1955, it suffered net losses and in fact, its gross assets suffered a gradual decrease for the same years, and that a similar downward trend took place in its surplus and capital position during the same period of time, the respondent Commissioner of Internal Revenue did not act arbitrarily in disallowing as deductible expenses the amounts thus paid by the company as bonus or "additional remuneration" in accordance with Section 30(a) (1) of the National Internal Revenue Code.

2. ID.; ID.; ID.; ID.; COMPANY'S POLICY OF LOW SALARY BUT WITH SUBSTANTIAL BONUSES NOT A JUSTIFICATION.— Petitioner justifies payment of the bonuses in question to its top officials by saying that its general salary policy was to give a low salary but to grant substantial bonuses at the end of each year, so that its officers may receive considerable lump sums with which to purchase whatever expensive objects or items they might need. While the Court

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is not prepared to hold that such policy is unreasonable, still its application should not result in producing a net loss for the employer at the end of the year, for if that were to be the case, the scheme may be utilized to freely achieve some other purpose-evade payment of taxes.

3. ID.; ID.; ID.; ID.; QUESTION OF ALLOWANCE EXCLUSIVELY LODGED IN COMMISSIONER OF INTERNAL REVENUE.— The question of allowing or disallowing as deductible expenses the amounts paid to corporate officers by way of bonus is determined by the Commissioner of Internal Revenue exclusively for income tax purposes. Concededly, he has no authority to fix the amounts to be paid to corporate officers by way of basic salary, bonus or additional remuneration—a matter that lies more or less exclusively within the sound discretion of the corporation itself. But this right of the corporation is, of course, not absolute. It cannot exercise it for the purpose of evading payment of taxes legitimately due to the State.

APPEARANCES OF COUNSEL

*Angel S. Gamboa* for petitioner.

*Solicitor General Arturo A. Alafriz, Assistant Solicitor General* ***Jose P. Alejandro*** and ***Special Attorney Virgilio C. Saldajeno*** for respondent.

DECISION

DIZON, *J.*:

Petition filed by Kuenzle & Streiff, Inc. for the review of the decision of the Court of Tax Appeals in C.T.A. Case No. 551 sustaining the assessments of the respondent issued against it, for deficiency income taxes for the years 1953, 1954 and 1955 in the amounts of ₱40,455.00, ₱11,248.00 and ₱16,228.00, respectively, arising from the disallowance, as deductible expenses, of the bonuses paid by petitioner to its officers, upon the ground that they were not ordinary, nor necessary, nor reasonable expenses within the purview of Section 30(a) (1) of the National Internal Revenue Code.

Petitioner, a domestic corporation, filed its income tax returns for the taxable years 1953, 1954 and 1955, declaring net losses

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of ₱2,085.84, ₱4,953.91 and ₱9,246.07, respectively. Upon a verification thereof, the respondent, on September 9, 1957, assessed against it the deficiency income taxes in question, arrived at as follows:

For the year 1953, by disallowing as deductions all amounts paid that year by the petitioner as bonus to its officers and staff-members in the aggregate sum of ₱175,140.00, this resulting in a net taxable income of petitioner amounting to ₱173,054.16; for the taxable years 1954 and 1955, the similar disallowance as deductions of a portion of the bonuses paid by petitioner in said years to its officers and staff-members in the aggregate sums of ₱88,193.33 for 1954 and ₱90,385.00 for 1955, resulted likewise in a net taxable income for petitioner in the sum of ₱83,239.42 for 1954 and ₱81,138.93 for 1955.

On July 9, 1958 petitioner filed with the Court of Tax Appeals a petition for review contesting the aforementioned assessments (C.T.A. Case No. 551), and on April 28, 1961, said Court rendered judgment as follows:

"FOR THE FOREGOING CONSIDERATIONS, the decision appealed from is hereby affirmed with respect to the deficiency assessment for the years 1953 and 1955. As regards the deficiency assessment for the year 1954, the same is hereby modified in the sense that the amount due from petitioner is ₱11,248.00, instead of ₱16,648.00. Accordingly, petitioner is ordered to pay within thirty days from the date this decision becomes final the sums of ₱40,455.00 and ₱16,228.00, plus 5% surcharge and 1% monthly interest from October 1, 1957 until paid. It is likewise ordered to pay the sum of ₱11,248.00 within the same period, and, if not so paid, there shall be added thereto 5% surcharge and 1% monthly interest from the date of delinquency to the date of payment. With costs against petitioner."

Petitioner moved for a reconsideration of the abovequoted decision, and on August 21, 1961, the court amended the same to include the following at the end thereof:

". . . In both cases, the maximum amount of interest shall not exceed the amount corresponding to a period of three years, pursuant to Section 51(e) (2) of the National Internal Revenue Code, as amended by Section 8 of Republic Act No. 2343. With costs against petitioner."

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Having found that the bonuses in question were paid for services actually rendered by the recipients thereof, the tax court proceeded to consider the question of "whether or not they are reasonable." In this connection it construed Section 30(a) (1) of the Revenue Code as allowing the deduction from gross income of all the ordinary and necessary expenses incurred during the taxable year in carrying on the trade or business of the taxpayer, including a *reasonable allowance* for salaries or other compensation for personal services actually rendered. We agree with the view thus expressed, as well as with said court's conclusion that the bonuses in question were *not* reasonable considering all material and relevant factors.

Petitioner contends that the tax court, in arriving at its conclusion, acted "in a purely arbitrary manner," and erred in not considering individually the total compensation paid to each of petitioner's officers and staff members in determining the reasonableness of the bonuses in question, and that it erred likewise in holding that there was nothing in the record indicating that the actuation of the respondent was unreasonable or unjust.

It is not true, as petitioner claims to support its view, that the respondent and the tax court based their ruling exclusively upon the fact that petitioner had suffered net losses in its business operations during the years when the bonuses in question were paid. The truth appears to be that, in arriving at such conclusion, the respondent and the tax court gave due consideration to all the material factors that led this Court to decide an earliest case of petitioner itself involving the same issue and where the test for determining the reasonableness of bonuses and additional compensation for services actually rendered were laid down by Us as follows:

"It is a general rule that 'Bonuses to employees made in good faith and as additional compensation for the services actually rendered by the employees are deductible provided such payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered' (4 Mertens, Law of Federal Income Taxation, Sec. 25-50, p. 410).

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The condition precedents to the deduction of bonuses to employees are: (1) the payment of the bonuses is in fact compensation; (2) it must be for personal services actually rendered; and (3) bonuses, when added to the salaries, are 'reasonable . . . when measured by the amount and quality of the services performed with relation to the business of the particular taxpayer' (Idem., Sec. 25.44, p. 395). Here it is admitted that the bonuses are in fact compensation and were paid for services actually rendered. The only question is whether the payment of said bonuses is reasonable.

"There is no fixed test for determining the reasonableness of a given bonus as compensation. This depends upon many factors, one of them being 'the amount and quality of the services performed with relation to the business'. Other tests suggested are: payment must be 'made in good faith'; 'the character of the taxpayer's business, the volume and amount of its net earnings, its locality, the type and extent of the services rendered, the salary policy of the corporation'; 'the size of the particular business'; 'the employees' qualifications and contributions to the business venture'; and 'general economic conditions' (4 Mertens Law of Federal Income Taxation, Secs. 25.44, 25.49, 25.50, 25.51, pp. 407-412). However, 'in determining whether the particular salary or compensation payment is reasonable, the situation must be considered as a whole.' Ordinarily, no single factor is decisive. . . . it is important to keep in mind that it seldom happens that the application of one test can give a satisfactory answer, and that ordinarily it is the interplay of several factors, properly weighted for the particular case, which must furnish the final answer (Idem.)." (Kuenzle & Streiff *v.* Coll. of Int. Rev., G.R. Nos. L-12010 & L-12113, Oct. 20, 1959.)

Making a distinction between petitioner's previous case and the present, the tax court said that while it is true that in the former (C.T.A. No. 169, December 29, 1956, G.R. Nos. L-12010 and L-12113, October 20, 1959, involving taxable years 1950 to 1952) We allowed—and considered deductible—bonuses in amounts bigger than the ones allowed by respondent in the case at bar, that was due to the fact that petitioner had earned huge profits during the years 1950-52. So much so that, the payment of such bonuses notwithstanding, petitioner still had substantial net profits distributable as dividends among its stockholders. In the present case, on the other hand, it is clear that the ultimate and inevitable result of the payment of the questioned bonuses would be *net*

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*losses* for petitioner during the taxable years in which they were paid.

It seems clear from the record that, in arriving at its main conclusion, the tax court considered, inter alia, the following factors:

In the first place, for the years 1953, 1954 and 1955 the petitioner paid to its following top officers: A.P. Kuenzle, H.A. Streiff, A. Jung, G. Cattaneo, A. Schatzmann, F.E. Rein, M. Klingler, A. Huber, S. Meili, M. Triaca, J. Ortiz, H. Vogt, W, Ramp, W. Strehler, H.R. Jung, K. Schedler, P.C. Curtis, R. Oefeli, substantial amounts as salaries and bonuses ranging from ₱9,000.00 yearly as a minimum (except in one case) and ₱50,000.00 as maximum. All these officials headed various departments of petitioner's business. While it must be assumed, on the one hand, in the absence of evidence to the contrary, that they were competent, on the other the record discloses no evidence nor has petitioner ever made the claim that all or some of them were gifted with some special talent, or had undergone some extraordinary training, or had accomplished any particular task, that contributed materially to the success of petitioner's business during the taxable years in question.

In the second place, working under the abovenamed officials and constituting what we might call the staff of petitioner's working personnel, were a good number of other employees—mostly Filipinos (T.s.n., pp. 222-223)—all of whom, according to the record (Idem, 223), received no pay increase at all during the same years.

In the third place, the above salaries and bonuses were paid to petitioner's top officials mentioned heretofore, in spite of the fact that according to its income tax returns for the relevant years, it has suffered net losses as follows; ₱2,085.84, ₱4,953.91, ₱9,246.07 for the years 1953, 1954 and 1955, respectively. In fact, petitioner's financial statements further show that its gross assets suffered a gradual decrease for the same years (Exh. B-1, p. 58,

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B.I.R. records, Exh. D-1, p. 36 id., Exh. F-1, p. 14 id.), and that a similar downward trend took place in its surplus and capital position during the same period of time.

That the charge of arbitrariness against respondent is without merit is further shown by the following considerations:

Petitioner admits that the amounts it paid to its top officers in 1953 as bonus or "additional remuneration" were taken either from operating funds, that is, funds from the year's business operations, or from its general reserve. Normally, the amounts taken from the first source should have constituted profits of the corporation distributable as dividends amongst its shareholders. Instead it would appear that they were diverted from this purpose and used to pay the bonuses for the year 1953. In the case of the amounts taken from the general reserve it seems clear that the company had to resort to the use of such reserve funds because the item of expense to be met could not be considered as ordinary or necessary—and was therefore beyond the purview of the provisions of Section 30(a) (1) of the National Internal Revenue Code. This being so, We can not see our way clear to holding that the respondent acted arbitrarily in disallowing as deductible expenses the amounts thus paid as bonus or "additional remuneration."

Neither does the total disallowance of the bonuses paid to some officers and the partial disallowance of those paid to others show that respondent acted unjustly and unreasonably. The record sufficiently shows that the total disallowance was more or less due to the fact that the affected officers had previously received substantial increases in their basic salaries.

Petitioner justifies payment of these bonuses to its top officials by saying that its general salary policy was to give a low salary but to grant substantial bonuses at the end of each year, so that its officers may receive considerable *lump sums* with which to purchase whatever expensive objects or items they might need. While We are not prepared to hold that such policy is

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unreasonable, still We believe that its application should not result in producing a *net loss* for the employer at the end of the year, for if that were to be the case, the scheme may be utilized to freely achieve some other purpose—evade payment of taxes.

The authority relied upon by petitioner (Mertens Law of Federal Income Taxation, Vol. IV, p. 418) does not apply to the present case, because it refers to the *salary* paid to an employee, which may be claimed as a deductible amount. In the case before Us the respondent does not question the basic salaries paid by petitioner to its officers and employees, but disallowed only the bonuses paid to petitioner's top officers at the end of the taxable years in question.

In further support of its appeal petitioner claims that the amounts disallowed by the respondent should be considered as legitimate business expenses as their payment was made in good faith. In bringing up this point, petitioner treads on dangerous ground. In the first place, good faith can not decide whether a business expense is reasonable or unreasonable for purposes of income tax deduction. In the second place, petitioner's good faith in the matter at issue is not overly manifest, considering that the questioned bonuses were fixed and paid at the end of the years in question—at a time, therefore, when petitioner fully knew that it was going to suffer a net loss in its business operations.

As far as petitioner's contention that as employer it has the right to fix the compensation of its officers and employees and that it was in the exercise of such right that it deemed proper to pay the bonuses in question, all that We need say is this: that right may be conceded, but for income tax purposes the employer can not legally claim such bonuses as deductible expenses unless they are shown to be reasonable. To hold otherwise would open the gate to rampant tax evasion.

Lastly, We must not lose sight of the fact that the question of allowing or disallowing as deductible expenses the amounts paid to corporate officers by way of bonus is determined by

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respondent exclusively for income tax purposes. Concededly, he has no authority to fix the amounts to be paid to corporate officers by way of basic salary, bonus or additional remuneration—a matter that lies more or less exclusively within the sound discretion of the corporation itself. But this right of the corporation is, of course, not absolute. It can not exercise it for the purpose of evading payment of taxes legitimately due to the State.

WHEREFORE, the appealed decision being in accordance with law, the same is hereby affirmed, with costs.

*Reyes, J.B.L.(Acting C.J.), Makalintal, Zaldivar, Sanchez, Fernando, Capistrano, Teehankee* and *Barredo, JJ.*, concur.

*Concepcion, C.J.,* and *Ruiz Castro, J.,* are on official leave of absence.

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[G.R. No. L-23275. May 29, 1969]

VICENTE CARBAJAL AND ARCADIO QUEMADA, plaintiffs-appellees, *vs.* PONCIANA DIOLOLA, MIGUEL AMOYAN, SILVESTRE AMOYAN and BENITO ABELLA, defendants-appellants.

SYLLABUS

1. REMEDIAL LAW; PROCEDURE; MOTION TO DISMISS; INSUFFICIENCY OF PLAINTIFF'S EVIDENCE; RULE IN CASE OF DENIAL OF MOTION.— Where after plaintiffs had rested their case, defendants filed a motion to dismiss on the ground of insufficiency of plaintiffs' evidence but did not waive their right to present evidence in the event their motion would be denied, defendants' contention that the lower court erred in not allowing them to present their evidence because their motion did not contain a reservation of their right to present evidence in case of denial of their motion, is meritorious. Under Rule 35 of the Revised Rules of Court, what extinguishes defendant's right to present evidence is the waiver or renunciation thereof. Reservation by the defendant of the right to present evidence is not necessary because the rule itself reserves such right to the defendant.