

[**G.R. No. 123206, March 22, 2000**]

**COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS .
COURT OF APPEALS, COURT OF TAX APPEALS AND JOSEFINA P.
PAJONAR, AS ADMINISTRATRIX OF THE ESTATE OF PEDRO P.
PAJONAR, RESPONDENTS.**

R E S O L U T I O N

GONZAGA-REYES, J.:

Assailed in this petition for review on *certiorari* is the December 21, 1995 Decision^[1] of the Court of Appeals^[2] in CA-G.R. Sp. No. 34399 affirming the June 7, 1994 Resolution of the Court of Tax Appeals in CTA Case No. 4381 granting private respondent Josefina P. Pajonar, as administratrix of the estate of Pedro P. Pajonar, a tax refund in the amount of P76,502.42, representing erroneously paid estate taxes for the year 1988.

Pedro Pajonar, a member of the Philippine Scout, Bataan Contingent, during the second World War, was a part of the infamous Death March by reason of which he suffered shock and became insane. His sister Josefina Pajonar became the guardian over his person, while his property was placed under the guardianship of the Philippine National Bank (PNB) by the Regional Trial Court of Dumaguete City, Branch 31, in Special Proceedings No. 1254. He died on January 10, 1988. He was survived by his two brothers Isidro P. Pajonar and Gregorio Pajonar, his sister Josefina Pajonar, nephews Concordio Jandog and Mario Jandog and niece Conchita Jandog.

On May 11, 1988, the PNB filed an accounting of the decedent's property under guardianship valued at P3,037,672.09 in Special Proceedings No. 1254. However, the PNB did not file an estate tax return, instead it advised Pedro Pajonar's heirs to execute an extrajudicial settlement and to pay the taxes on his estate. On April 5, 1988, pursuant to the assessment by the Bureau of Internal Revenue (BIR), the estate of Pedro Pajonar paid taxes in the amount of P2,557.

On May 19, 1988, Josefina Pajonar filed a petition with the Regional Trial Court of Dumaguete City for the issuance in her favor of letters of administration of the estate of her brother. The case was docketed as Special Proceedings No. 2399. On July 18, 1988, the trial court appointed Josefina Pajonar as the regular administratrix of Pedro Pajonar's estate.

On December 19, 1988, pursuant to a second assessment by the BIR for deficiency estate tax, the estate of Pedro Pajonar paid estate tax in the amount of P1,527,790.98. Josefina Pajonar, in her capacity as administratrix and heir of Pedro Pajonar's estate, filed a protest on January 11, 1989 with the BIR praying that the estate tax payment in the amount of P1,527,790.98, or at least some portion of it, be returned to the heirs.^[3]

However, on August 15, 1989, without waiting for her protest to be resolved by the BIR, Josefina Pajonar filed a petition for review with the Court of Tax Appeals (CTA), praying for the refund of P1,527,790.98, or in the alternative, P840,202.06, as erroneously paid estate tax.^[4] The case was docketed as CTA Case No. 4381.

On May 6, 1993, the CTA ordered the Commissioner of Internal Revenue to refund Josefina Pajonar the amount of P252,585.59, representing erroneously paid estate tax for the year 1988.^[5]

Among the deductions from the gross estate allowed by the CTA were the amounts of P60,753 representing the notarial fee for the Extrajudicial Settlement and the amount of P50,000 as the attorney's fees in Special Proceedings No. 1254 for guardianship.^[6]

On June 15, 1993, the Commissioner of Internal Revenue filed a motion for reconsideration^[7] of the CTA's May 6, 1993 decision asserting, among others, that the notarial fee for the Extrajudicial Settlement and the attorney's fees in the guardianship proceedings are not deductible expenses.

On June 7, 1994, the CTA issued the assailed Resolution^[8] ordering the Commissioner of Internal Revenue to refund Josefina Pajonar, as administratrix of the estate of Pedro Pajonar, the amount of P76,502.42 representing erroneously paid estate tax for the year 1988. Also, the CTA upheld the validity of the deduction of the notarial fee for the Extrajudicial Settlement and the attorney's fees in the guardianship proceedings.

On July 5, 1994, the Commissioner of Internal Revenue filed with the Court of Appeals a petition for review of the CTA's May 6, 1993 Decision and its June 7, 1994 Resolution, questioning the validity of the abovementioned deductions. On December 21, 1995, the Court of Appeals denied the Commissioner's petition.^[9]

Hence, the present appeal by the Commissioner of Internal Revenue.

The sole issue in this case involves the construction of section 79^[10] of the National Internal Revenue Code^[11] (Tax Code) which provides for the allowable deductions from the gross estate of the decedent. More particularly, the question is whether the notarial fee paid for the extrajudicial settlement in the amount of P60,753 and the attorney's fees in the guardianship proceedings in the amount of P50,000 may be allowed as deductions from the gross estate of decedent in order to arrive at the value of the net estate.

We answer this question in the affirmative, thereby upholding the decisions of the appellate courts.

In its May 6, 1993 Decision, the Court of Tax Appeals ruled thus:

Respondent maintains that only judicial expenses of the testamentary or intestate proceedings are allowed as a deduction to the gross estate. The amount of P60,753.00 is quite extraordinary for a mere notarial fee.

This Court adopts the view under American jurisprudence that expenses incurred in the extrajudicial settlement of the estate should be allowed as a deduction from the gross estate. "There is no requirement of formal administration. It is sufficient that the expense be a necessary contribution toward the settlement of the case." [*34 Am. Jur. 2d, p. 765; Nolledo, Bar Reviewer in Taxation, 10th Ed. (1990), p. 481*]

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The attorney's fees of P50,000.00, which were already incurred but not yet paid, refers to the guardianship proceeding filed by PNB, as guardian over the ward of Pedro Pajonar, docketed as Special Proceeding No. 1254 in the RTC (Branch XXXI) of Dumaguete City. x x x

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The guardianship proceeding had been terminated upon delivery of the residuary estate to the heirs entitled thereto. Thereafter, PNB was discharged of any further responsibility.

Attorney's fees in order to be deductible from the gross estate must be essential to the collection of assets, payment of debts or the distribution of the property to the persons entitled to it. The services for which the fees are charged must relate to the proper settlement of the estate. [*34 Am. Jur. 2d 767.*] In this case, the guardianship proceeding was necessary for the distribution of the property of the late Pedro Pajonar to his rightful heirs.

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PNB was appointed as guardian over the assets of the late Pedro Pajonar, who, even at the time of his death, was incompetent by reason of insanity. The expenses incurred in the guardianship proceeding was but a necessary expense in the settlement of the decedent's estate. Therefore, the attorney's fee incurred in the guardianship proceedings amounting to P50,000.00 is a reasonable and necessary business expense deductible from the gross estate of the decedent.^[12]

Upon a motion for reconsideration filed by the Commissioner of Internal Revenue, the Court of Tax Appeals modified its previous ruling by reducing the refundable amount to P76,502.43 since it found that a deficiency interest should be imposed and the compromise penalty excluded.^[13] However, the tax court upheld its previous ruling regarding the legality of the deductions -

It is significant to note that the inclusion of the estate tax law in the codification of all our national internal revenue laws with the enactment of the National Internal Revenue Code in 1939 were copied from the Federal Law of the United States. [UMALI, Reviewer in Taxation (1985), p. 285] The 1977 Tax Code, promulgated by Presidential Decree No.

1158, effective June 3, 1977, reenacted substantially all the provisions of the old law on estate and gift taxes, except the sections relating to the meaning of gross estate and gift. [Ibid, p. 286.]

In the United States, [a]dministrative expenses, executor's commissions and attorney's fees are considered allowable deductions from the Gross Estate. Administrative expenses are limited to such expenses as are actually and necessarily incurred in the administration of a decedent's estate. [PRENTICE-HALL, Federal Taxes Estate and Gift Taxes (1936), p. 120, 533.] Necessary expenses of administration are such expenses as are entailed for the preservation and productivity of the estate and for its management for purposes of liquidation, payment of debts and distribution of the residue among the persons entitled thereto. [Lizarraga Hermanos vs. Abada, 40 Phil. 124.] They must be incurred for the settlement of the estate as a whole. [34 Am. Jur. 2d, p. 765.] Thus, where there were no substantial community debts and it was unnecessary to convert community property to cash, the only practical purpose of administration being the payment of estate taxes, full deduction was allowed for attorney's fees and miscellaneous expenses charged wholly to decedent's estate. [Ibid., citing Estate of Helis, 26 T .C. 143 (A).]

Petitioner stated in her protest filed with the BIR that "upon the death of the ward, the PNB, which was still the guardian of the estate, (Annex 'Z'), did not file an estate tax return; however, it advised the heirs to execute an extrajudicial settlement, to pay taxes and to post a bond equal to the value of the estate, for which the estate paid P59,341.40 for the premiums. (See Annex 'K')." [p. 17, CTA record.] Therefore, it would appear from the records of the case that the only practical purpose of settling the estate by means of an extrajudicial settlement pursuant to Section 1 of Rule 74 of the Rules of Court was for the payment of taxes and the distribution of the estate to the heirs. A fortiori, since our estate tax laws are of American origin, the interpretation adopted by American Courts has some persuasive effect on the interpretation of our own estate tax laws on the subject.

Anent the contention of respondent that the attorney's fees of P50,000.00 incurred in the guardianship proceeding should not be deducted from the Gross Estate, We consider the same unmeritorious. Attorneys' and guardians' fees incurred in a trustee's accounting of a taxable *inter vivos* trust attributable to the usual issues involved in such an accounting was held to be proper deductions because these are expenses incurred in terminating an *inter vivos* trust that was includible in the decedent's estate. (Prentice Hall, Federal Taxes on Estate and Gift, p.120, 861] Attorney's fees are allowable deductions if incurred for the settlement of the estate. It is noteworthy to point that PNB was appointed the guardian over the assets of the deceased. Necessarily the assets of the deceased formed part of his gross estate. Accordingly, all expenses incurred in relation to the estate of the deceased will be deductible for estate tax purposes provided these are necessary and ordinary expenses for administration of the settlement of the estate.^[14]

In upholding the June 7, 1994 Resolution of the Court of Tax Appeals, the Court of Appeals held that: Newmiso

2. Although the Tax Code specifies "judicial expenses of the testamentary or intestate proceedings," there is no reason why expenses incurred in the administration and settlement of an estate in extrajudicial proceedings should not be allowed. However, deduction is limited to such administration expenses as are actually and necessarily incurred in the collection of the assets of the estate, payment of the debts, and distribution of the remainder among those entitled thereto. Such expenses may include executor's or administrator's fees, attorney's fees, court fees and charges, appraiser's fees, clerk hire, costs of preserving and distributing the estate and storing or maintaining it, brokerage fees or commissions for selling or disposing of the estate, and the like. Deductible attorney's fees are those incurred by the executor or administrator in the settlement of the estate or in defending or prosecuting claims against or due the estate. (Estate and Gift Taxation in the Philippines, T. P. Matic, Jr., 1981 Edition, p. 176).

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It is clear then that the extrajudicial settlement was for the purpose of payment of taxes and the distribution of the estate to the heirs. The execution of the extrajudicial settlement necessitated the notarization of the same. Hence the Contract of Legal Services of March 28, 1988 entered into between respondent Josefina Pajonar and counsel was presented in evidence for the purpose of showing that the amount of P60,753.00 was for the notarization of the Extrajudicial Settlement. It follows then that the notarial fee of P60,753.00 was incurred primarily to settle the estate of the deceased Pedro Pajonar. Said amount should then be considered an administration expenses actually and necessarily incurred in the collection of the assets of the estate, payment of debts and distribution of the remainder among those entitled thereto. Thus, the notarial fee of P60,753 incurred for the Extrajudicial Settlement should be allowed as a deduction from the gross estate.

3. Attorney's fees, on the other hand, in order to be deductible from the gross estate must be essential to the settlement of the estate.

The amount of P50,000.00 was incurred as attorney's fees in the guardianship proceedings in Spec. Proc. No. 1254. Petitioner contends that said amount are not expenses of the testamentary or intestate proceedings as the guardianship proceeding was instituted during the lifetime of the decedent when there was yet no estate to be settled.

Again , this contention must fail.

The guardianship proceeding in this case was necessary for the distribution of the property of the deceased Pedro Pajonar. As correctly pointed out by respondent CTA, the PNB was appointed guardian over the