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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

January 25, 1962

YEK HUA TRADING CORPORATION,
Petitioner,

- versus - C.T.A. CASE NO. 580

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

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D E C I S I O N

This is an appeal from the decision of the Commissioner of Internal Revenue requiring petitioner to pay the amount of ₱39,411.00 as deficiency income tax for the year 1951.

Petitioner is a corporation duly organized and existing under the laws of the Republic of the Philippines, engaged, among others, in the importation and exportation of general merchandise, hardware, machineries and other goods.

On March 23, 1951, petitioner entered into a contract with the Union Import & Export Corporation (hereinafter referred to as "Union"), whereby it agreed to buy from the latter 500 metric tons of copra. To guarantee its compliance with the terms of the contract, petitioner deposited with Union on March 29, 1951 the sum of ₱150,000.00. Sometime in December, 1951, the contract of sale was cancelled in a verbal agreement between Alfonso SyCip, president of petitioner Yek Hua Trading Corporation, and James Liu Choklin, general manager of Union. As penalty for the cancellation of the contract, petitioner agreed to pay the amount of ₱80,000.00. This amount was charged against petitioner's deposit of ₱150,000.00 with Union and was taken up in petitioner's books of accounts in 1951. However, the balance of ₱70,000.00 was returned by the latter only on February 7, 1952.

Petitioner is controlled by Alfonso SyCip and his children, they being admittedly the owners of the majority stocks therein. Furthermore, Alfonso SyCip is the president of both petitioner and Union, but in 1951, he and his three (3) children owned only 1000 Union shares at a par value of ₱100.00 each or ₱100,000.00 interest holding as against the total subscribed and outstanding shares of 12,000 with a total par value of ₱1,200,000.00. Percentagewise, Alfonso SyCip and his children held interest amounting to only 8.33% of the total subscribed and outstanding shares of the Union.

Besides engaging in the importation and exportation business, petitioner is also engaged in the indent business. Sometime in 1951, petitioner was able to book orders of local importers for about 1,800 sacks of Brazilian coffee beans from two (2) foreign suppliers, the H. M. Newhall & Co. and the Fidelity Trading Co., Inc. The importation of these Brazilian coffee beans was authorized under licenses previously approved by the PRISCO, which was then the licensing agency of the Government. However, these licenses were subsequently cancelled by the said Government agency. Hence, the local buyers, who had previously placed orders, refused to open letters of credit in favor of the foreign suppliers. As a result of the refusal to open letters of credit, the exportation of the coffee beans could not be made by the foreign suppliers to the local purchasers. Consequently, petitioner directed the Fidelity Trading Co., Inc. and the H. M. Newhall & Co. to cancel the orders and to sell the coffee beans intended for the local buyers. The coffee beans were sold by the foreign suppliers at a loss because, at the time of sale, the prevailing market price of coffee was at a decline. Petitioner paid to the Fidelity Trading Co., Inc. and H. M. Newhall and Co. the respective sums of ₱27,060.00 and ₱13,200.00 or a total of ₱40,260.00 representing the fifty __per centum__ share in the total loss arising from the cancellation of the coffee orders.

On April 20, 1952, petitioner filed its 1951 income tax return, wherein it claimed as deductions several items, which, among others, were the amounts of ₱80,000.00 as copra losses and ₱40,260.00 as coffee losses. After an investigation and on the basis of the report rendered by his agent, respondent disallowed the claimed deductions and, consequently, assessed and demanded from petitioner the payment of the amount of ₱39,411.00 as deficiency income taxes for 1951, arrived at as follows:

Net income		₱ 94,289.82
Add: disallowances:		
1. Copra losses as indentor.	₱80,000.00	
2. Coffee losses " " .	40,260.00	
" " (price decline)....	3,461.55	
3. Loss on copra outturn....	5,068.38	
" " (wharfage).......	1,018.00	
4. Bad debts	5,992.49	
5. Miscellaneous expenses...	6,534.90	
6. Taxes and licenses	50.00	142,385.32
Net income per investigation		₱236,675.14
Tax due thereon		58,269.00
Less tax already paid		18,858.00
Tax due and collectible .... (Exhibit 6)		₱ 39,411.00

The request to reconsider the disallowance of the deduction claims for copra and coffee losses having been denied, petitioner interposed the present appeal, which is limited only to the disallowed items of ₱80,000.00 and ₱40,260.00.

The pertinent provision of the Internal Revenue Code involved in this case provides:

> "Sec. 30. Deductions from gross income. - In computing net income there shall be allowed as deductions -- x x x
> (d) Losses:
> (1) By individuals -- x x x
> (2) By corporations -- In the case of a corporation, all losses actually sustained and charged off within the taxable year and not compensated for by insurance or otherwise."

The issues raised for our consideration are as follows:

(1) Whether or not petitioner incurred copra losses in the amount of ₱80,000.00 as to warrant the deduction thereof in its 1951 income tax return; and

(2) Whether or not petitioner can claim as deduction from its gross income the amount of ₱40,260.00 representing coffee losses.

With respect to the first issue, petitioner contends that the evidence submitted by it during the trial sufficiently establishes that it incurred ₱80,000.00 copra losses, which are deductible from its 1951 gross income. On the other hand, respondent adopts the contrary position, arguing that petitioner was under no obligation to pay Union a penalty of ₱80,000.00 and there is no sufficient proof that such penalty was actually paid. Even on the assumption that there was actual and valid payment, he contends that the same should be considered a loss sustained in 1952 and, therefore, is not deductible in 1951.

We find the contention of petitioner meritorious. The uncontradicted evidence, testimonial and documentary, indicates that on March 23, 1951, petitioner and Union entered into a contract for the purchase by the former of copra; that to insure faithful compliance with the terms of the said contract, petitioner deposited with Union the sum of ₱150,000.00 in check; that in view of the fast decline of the price of copra in the foreign market and to minimize the subsequent loss, the contract for purchase and sale of copra was cancelled in 1951 in a verbal agreement between Alfonso SyCip, president of petitioner corporation, and James Liu Choklin, general manager of Union; that in consideration of the cancellation of the contract, the sum of ₱80,000.00 was charged against the deposit of ₱150,000.00; that the sum of ₱80,000.00, for which a journal voucher was prepared, was entered in petitioner's general journal as copra loss; and that after deducting the amount of ₱80,000.00 from the deposit of ₱150,000.00, Union, on February 7, 1952, refunded to petitioner the amount of ₱70,000.00 in check, which last amount was entered in petitioner's cash book.

The foregoing evidence demonstrates the validity of petitioner's obligation to pay the ₱80,000.00 as reparation for losses suffered by Union in consequence of the cancellation of the contract for the purchase of copra. The payment of ₱80,000.00 by petitioner constitutes a loss, and there being no showing that the same was compensated for by insurance or otherwise, it is deductible under Section 30(d)(2) of the Tax Code.

The fact that the amount of ₱80,000.00 does not appear as having been entered in the books of Union either in 1951 and 1952 does not preclude the conclusion that petitioner sustained such loss. Petitioner and Union have distinct personalities. Hence, failure on the part of one to reflect in its books transactions it had with the other will not affect the right of the latter. For the existence of a loss is reflected more by direct and primary evidence and not by the books of accounts as these records do not show the true nature of the transactions (Muñoz vs. Hood, 12 Phil. 624, 639).

The alternative contention of respondent to the effect that assuming there was a Copra loss of ₱80,000.00, the said loss was sustained by petitioner in 1952 and not in 1951 is not well founded. Deductions for losses sustained are proper only in the year in which liability therefor becomes fixed, regardless of whether payment has been made or postponed (M. A. Burns Mfg. Co. vs. Commissioner, 59 F 2d 504, 11 AFTR 26; N. Sobel, Inc. vs. Commissioner, 40 B.T.A. 1263). In the case at bar, where the taxpayer, who records its income and expenses on the accrual basis, paid, upon mutual agreement, and debited in its books, the amount of ₱80,000.00 as loss sustained, the said loss is deductible in 1951 when the agreement to pay was made, for it was then that the liability therefor became fixed (M. A. Burns Mfg. Co. vs. Commissioner, ibid; Deerland Turpentine Co., 4 B.T.A. 1236; Landers Bros. Co. vs. Commissioner, 17 B.T.A. 1078; David Hanover vs. Commissioner, 12 TC 342).

Anent the second issue, respondent contends that the deduction of coffee losses in the amount of ₱40,260.00 is not deductible as petitioner is not the party legally liable for the loss. He insists that the payment of ₱40,260.00 being a voluntary payment by petitioner of losses sustained by the two foreign companies, the same is not a deductible loss.

We agree with petitioner that its share in the loss in the sum of ₱40,260.00 is an allowable deduction for losses sustained in 1951. It is not a voluntary payment of obligations of others, but is one incurred in connection with transactions pertinent to the conduct of its indent business. The liability to assume one-half of the losses in the coffee beans transaction arises from petitioner's legal obligation to repair the loss of Fidelity Trading Co., Inc. and the H. M. Newhall & Co. Its legal obligation springs from its contractual commitments, under its agency contracts (Exhibits S & M-3, pp. 88 & 173, C.T.A. rec.), to guarantee the foreign suppliers from losses arising from the default of the buyers, by virtue of which commitments, the said foreign suppliers could exact contribution, if not total restitution of the losses suffered by them. As petitioner had paid its share in the losses of the two (2) foreign suppliers, under a legal obligation to do so, it is the proper party entitled to the deduction of the amount of ₱40,260.00 as losses in its 1951 income tax return (Wiggin vs. Commissioner, 9 AFTR 818, Edward & John Burke, Ltd. vs. Commissioner, 3 TC 1031; Long vs. Glenn, 32 AFTR 1690).

In sum, the copra losses in the amount of ₱80,000 and coffee losses in the sum of ₱40,260.00 being deductible from its gross income in 1951, the deficiency income tax of petitioner for 1951 is computed as follows:

Net income		₱94,289.92
Add: disallowances:		
Coffee losses (price decline)	₱3,461.55	
Loss on copra Outturn	5,068.38	
Loss on copra (wharfage)	1,018.00	

Bad debts	5,992.49	
Miscellaneous Expenses...........	6,534.90	
Taxes and licenses	50.00	22,125.32
Taxable net income..................		₱116,415.24
Tax due thereon		₱ 24,596.00
Less tax already paid		18,858.00
Tax due and collectible..........		₱ 5,738.00

WHEREFORE, the decision of respondent is hereby modified. Petitioner is hereby ordered to pay the amount of ₱5,738.00 as deficiency income tax for 1951 within 30 days from the date this decision becomes final. If the said amount is not paid within said period, there shall be added to the unpaid amount a surcharge of 5%, plus interest at the rate of 1% per month to be computed in accordance with Section 51(e)(2) of the Tax Code, without pronouncement as to costs.

SO ORDERED.

Manila, Philippines, January 25, 1963.

MARIANO NABLE
Presiding Judge

WE CONCUR:

AUGUSTO M. LUCIANO
Associate Judge

ROMAN M. UMALI
Associate Judge