Lit

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

ATLAS CONSOLIDATED MINING
AND DEVELOPMENT CORPORATION,
Petitioner,

- versus - C.T.A. CASE NO. 2880

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

4/5/82

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DECISION

The facts and issues of this case as stated by our colleague, Judge Constante C. Roaquin, are as follows:

> "This is a suit brought by petitioner Atlas Consolidated Mining and Development Corporation for tax credit of the amount of ₱194,180.24, as alleged overpaid income tax caused by the disallowance by respondent Commissioner of Internal Revenue of the following items in petitioner's 1973 income tax return:
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> | | |
> |---|---|
> | 1. Notes receivable written off - | ₱155,189.90 |
> | 2. Compensation paid to ASAC- - - | 57,250.00 |
> | 3. ANSOR charges for postage, telephone and cable --- - - - | 161,765.45 |
> | 4. Interest expense - - - - - - | 107,536.09 |
> | | ₱481,741.34 |
>
> after no action was taken by respondent on its claim.
>
> As shown by the pleadings submitted by

the parties and records of the Bureau of Internal Revenue relevant to this case, it appears that petitioner is a domestic corporation engaged in the business of mining copper for export. As part of its operations, petitioner purchased machineries and equipment from its suppliers abroad. For this purpose, it hired the services of ANSOR, a foreign corporation based in New York and London. In the course of business, constant communication was exchanged between petitioner and ANSOR. Thus, ANSOR advanced expenses for postage, telephone and cables who periodically billed petitioner.

As stated above, petitioner purchased machineries and equipment from abroad. These purchases were on term or deferred-payment basis. When the importation arrived, it was recorded in the books of petitioner at an acquisition cost in dollar converted into Philippine peso at the prevailing exchange rate. The income tax return for that particular taxable year reflected such acquisition cost. In the succeeding year, when the bill for payment was received from the supplier, the exchange rate had gone higher than the exchange rate used in recording the acquisition cost. Petitioner had deducted in its income tax return this exchange rate differential in the sum of ₱107,536.09 as interest expense in the year of payment instead of adjusting the acquisition cost of said machineries and equipment.

The aforementioned deductions, namely: the expenses billed by ANSOR for postage, telephone, cable and the rate differential treated by petitioner as interest expense were disallowed by respondent in the 1973 income tax return.

Likewise, the deductions claimed by petitioner as notes receivables written off and compensation paid to ASAC were disallowed by respondent. However, petitioner had not pursued its claim for tax credit on these items."

Hence, the only remaining issues to be resolved in this case are:

1. Whether or not the disallowance by respondent of the deduction for postage, telephone and cable charges is proper; and

2. Whether or not the deduction of the exchange rate differential as interest expense instead of adjusting the acquisition cost of the imported machineries and equipment is allowable."

The members of this Court are not in dispute with respect to the second issue that the exchange rate differentials incurred as a result of installment payments on a deferred payment plan may be regarded as an expense as disposed of by Judge Roaquin in the following rationale:

> "We now come to the remaining issue. As indicated earlier, the exchange rate differential was the result of petitioner's importation of machineries and equipment on a term or deferred-payment basis. Thus, when the shipment arrived, the original acquisition cost of said equipment was the amount recorded in the books of petitioner but later, when the bill of payment was received from the supplier, the exchange rate had already risen. Petitioner then computed said difference which amounted to ₱107,536.09 and treated the same as interest expense deduction instead of capitalizing or adjusting it to the acquisition cost of the equipment. This was

allegedly done for reason of convenience, to the effect that such treatment no longer necessitate the annual amendment of the return where the differential occured, the annual adjustment of the cost when the importation was withdrawn from the customs, and considering the small amount of the differential compared to the amendatory work involved, the treatment did not in anyway diminish the tax liability of petitioner.

On the contrary, respondent disallowed the amount of ₱107,536.09 deducted by petitioner as part of interest expense in its 1973 tax return on the ground that being foreign exchange differential, it should not be treated as interest expense, but instead should have been added to the cost of the machineries and equipment imported.

It is not disputed that the exchange rate differentials arose as a result of petitioner's importations of machineries and equipment on a deferred payment basis. (See pet. memo. p. 151-153; resp. memo., p. 176, CTA rec.)

In conformity with the standard accounting practice, - "if acquisition of an asset is on a credit basis, the asset should be entered in the account at 'the amount of money immediately required to settle the obligation or . . . the amount of money which might have been raised directly through the use of the same instrument employed in making the credit purchase'." xx xx xx xx "Whether title technically passes or not at date of delivery, the preferred position under these conditions is to recognize plant cost immediately in the total amount of payments called for under the agreement, exclusive of interest, and to show the amount due as a liability." (Wixon, Accountants 'Handbook, Fourth Edition, p. (16-3). "When property is acquired on a deferred payment plan, and interest is charged on the unpaid balance of the contract, such interest should be recognized as an

> expense." (Simons and Karrenbrock, Intermediate Accounting, Fourth Edition, p. 410.)
>
> Following the accounting principle laid down above that interest paid in connection with the purchase of an asset on the deferred payment plan should be considered as an expense, similarly, exchange rate differentials incurred as a result of the installment payments should also be regarded as an expense. Furthermore, as cited above, if "the asset should be entered in the account at the amount of money immediately required to settle the obligation" when it is acquired on the credit basis, then its cost should be computed at the current exchange rate at the time of acquisition, regardless of exchange rate fluctuations at the time the deferred payments are made. Consequently, petitioner is entitled to the deduction of the interest expense of the amount of ₱107,536.09."

The collision occurs at the first issue. Petitioner claims that in 1973, the aforesaid expenses were advanced by its foreign agent Ansor and then periodically billed to petitioner for reimbursement. The records disclose that actually these expenses were charged by Ansor to petitioner in accordance with the following arrangement: "20% of all telephone, telegraph and telegraphic and 25% of all postal expenses incurred by Ansor in 1973", which means that petitioner is charged a certain percentage of all postage, telephone and cable expenses paid by Ansor for its overseas principals in the Far East of which petitioner is one of them. This proration was arrived at based on what Ansor judged to be a fair proportion of such expenses incurred by Ansor on behalf of petitioner. (See Exhibit A-N.Y., interoffice memorandum of the chief accountant of Ansor to the Assistant Corporate Secretary.)

Respondent objects to the allowance of these expenses on the principle that they are actually Ansor's own expenses, necessary and incidental to its business operations. That in order to justify these deductions, it must be shown by satisfactory proof or evidence that such expenses are related to and in furtherance of the purpose or purposes for which the supposed agency was constituted. To establish this, petitioner should have presented the "alleged existing agreement" so that it could have been examined to ascertain the true intent and scope of the agency as well as the terms and conditions embodied and stipulated therein. (Respondent's Memorandum, pp. 4 & 5.)

We believe this exception of respondent is well taken. A fundamental requirement for the deduction of a business expense is that such expense must be both ordinary and necessary. An expense which is merely necessary but not ordinary is not deductible even though paid or incurred in carrying on a trade or business. In determining what is "ordinary", the nature and scope of the taxpayer's business constitute a factor of considerable importance. Furthermore, a controlling guide is the kind of transaction involving the expenditure and its normalcy in the particular business under examination. (Mertens, Law of Federal Income Taxation, Vol. 4, 1978 Ed., Chapter 25.09, p. 51).

In the instant case, the postage, cable and telegraph expenses were in fact made by Ansor and not by petitioner. Following the usual practice, Ansor should have borne these communication expenses incurred by it in the performance of its undertakings for its principal. Since these were shifted instead to petitioner on a prorated basis, it becomes incumbent upon petitioner to prove that this arrangement is ordinary and necessary to the conduct of its agency agreement with Ansor. To this end, petitioner should have introduced as evidence the "existing service agreement". (t.s.n. p. 4, Deposition taken on Sept. 25, 1978.).

Supporting documents were submitted by petitioner to show that postage, telephone and cable expenses were actually disbursed by Ansor in 1973 for the benefit of its overseas principals and reimbursed by petitioner pursuant to the allocation formula applied by Ansor, but evidence as to the terms and conditions of the agency agreement was not produced.

As petitioner has failed to sustain the burden placed upon it, we are for resolving this issue in favor of respondent. Accordingly, petitioner's tax credit should be computed as follows:

Net income per return		₱260,647,194.00
Add: Unallowable deductions:		
Notes receivable written off	₱155,189.80	
Compensation paid	57,250.00	
Ansor charges for postage, telephone and cable	161,765.45	374,205.25
Net income per investigation		₱261,021,399.25
Tax due thereon		₱ 91,347,489.73
Less: Amount already assessed		91,216,518.00
Balance		₱ 130,971.73
Add: 14% interest from April 26, 1974 to May 26, 1975		19,864.04
Income tax deficiency		₱ 150,835.77
Less: Income tax deficiency paid		194,180.24
Amount of tax refundable		₱ 43,344.47

WHEREFORE, respondent Commissioner of Internal Revenue is hereby ordered to grant a tax credit in favor of petitioner Atlas Consolidated Mining and Development Corporation the amount of ₱43,344.47. Without pronouncement as to costs.

SO ORDERED.

Quezon City, Metro Manila, March 31, 1982

AMANTE FILLER
Presiding Judge

I CONCUR:

ALEX Z. REYES
Associate Judge

Associate Judge Constante C. Roaquin
dissents in part in a separate opinion.

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CONCURRING AND DISSENTING OPINION

I concur with my majority colleagues to the effect that the deductions claimed by petitioner as notes receivables written off in the sum of ₱155,189.80 and the compensation paid to ASAC in the amount of ₱57,250.00 were properly disallowed as deduction from gross income by respondent. In this regard, petitioner manifestly did not even pursue its claim for tax credit with reference to these disallowed items. I equally agree with the conclusion reached that the interest expense of ₱107,536.09 is allowed as deduction from gross income for reasons obvious in the majority decision.

I am, however, in disagreement with the conclusion of my majority colleagues that the disallowance by respondent of petitioner's deduction for postage, telephone and cable charges in the amount of ₱161,765.45 from its gross income is proper.

Petitioner has sufficiently proven that the disbursement for postage, telephone and cables were valid business expenses and are proper deductions in its 1973 income tax return. In substantiation of this business expense, petitioner had presented documentary evidence of the amounts advanced by and subsequently billed by ANSOR to petitioner for postage and telexes from November 1972 to August 1973, supported by invoices, applications for exchanges, and the corresponding confirmations of telegraphic transfers. (See Exhs. A to K-3, pp. 58-87, CTA rec.) The deposition of petitioner's witness, who testified in this connection with these charges or expenses, was also presented. (Exh. V, Deposition of Mr. Antonio C. Campo.) The facts wills out, therefore, that the expenses for postage, telephone and cables incurred in question are not actually ANSOR's own expenses incidental to its worldwide business operation But those of petitioner . I note that respon- ent had not assailed the business character of these expenses during the trial and failed to present evidence to contradict petitioner on this point. I also believe that petitioner is correct when it said in its Reply Memorandum (pp. 179-183, CTA rec.) that -

> " x x x The deductibility of these expenses for postage, telephone, telexes and cables does not depend for their proof on the existence of an agency contract. By advancing these expenses for petitioner, ANSOR established a debtor-creditor relationship. It billed petitioner for these expenses. Petitioner after satisfying itself with the business legitimacy of the expense paid the same, being business expense, it of course deducted them in its return."

While existence of an agency relationship, so far as the principal and agent are concerned, arises from consent, it is not essential that any formal contract of agency shall have been entered into between the principal and agent. For the existence of an agency can be inferred or implied from prior habits, or from the course of dealings of similar nature between the said parties, especially so where the agent has re- peatedly been permitted by the principal to per- form similar acts in the past. (3 Am. Jur. 2d, 428-429.) In other words, the non-presentation of the service agreement, contrary to my colleagues' views, is not material to show the existence of the agency relationship between petitioner Atlas Consolidated Mining and Development Corporation and ANSOR, as long as the former intended the latter to act for and in its behalf and that it had accepted to and did in fact acted for petitioner Atlas Consolidated Mining and Development Corporation. In the course of petitioner's operations of purchasing machineries and equipments from its suppliers abroad, it hired the services of ANSOR, a foreign corporation based in New York and London, and in the course of this business relation, constant communications were,therefore, exchanged between petitioner and ANSOR. As a result of these exchanges of communications, ANSOR had advanced, therefore the expenses for postage, telephone and cables which were periodically billed to and paid by petitioner, there is no question that these charges or expenses are not only necessary but ordinary to petitioner's business since in the latter case it is normally incurred in the course of its business relation for a period of time with ANSOR. Thus, when petitioner, in relation to its business, paid ANSOR for the communication charges-postage, telexes and cables in the amount of ₱161,765.45, deduction of the said amount of business expense from its gross income for 1973 is proper.

Consequently, it is my opinion that petitioner Atlas Consolidated Mining and Development Corporation should be entitled to the tax credit of the amount of ₱108,549.24, computed as follows:

Net income per return - - - - - -		₱260,647,194.00
Add: Unallowable deductions -		
Notes receivable - written off	₱155,189.80	
Compensation paid to ASAC -	₱ 57,250.00	212,439.80
Net income per investigation - -		₱260,859,633.80
Tax due thereon: - - - - - - - - -		₱ 91,290,872.00
Less: Amount already paid in 1973 - - - - - - - - - -		91,216,518.00
Balance - - - - - - - - - - - - - -		₱ 74,354.00
Add: 14% interest from 4-26-74 to 5-26-75 - - - -		11,277.00
Income tax deficiency - - - - - - -		₱ 85,631.00
Less: Deficiency income tax paid 6-25-75 - - - - - - - -		194,180.24
Amount of tax to be refunded - -		₱ 108,549.24

Quezon City, Metro Manila, April 5, 1982.

CONSTANTE C. ROAQUIN
Associate Judge