REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SIARI VALLEY ESTATES, INC.,
Petitioner,

- versus - C.T.A. CASE NO. 2625

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

10/18/74

x - - - - - - - - - - - - - x

D E C I S I O N

The substantial question posed by this case, as we see it, is whether a taxpayer on an accrual basis, who does not accrue and report the proceeds of a judgment in the year of entry, because of clear inability of the judgment debtor to satisfy the claim by reason of financial condition, should accrue and report such proceeds as income in latter year or years of actual receipt, as fixed and determined in an amicable settlement entered into by the taxpayer and the judgment debtpr.

As narrated by respondent, following are the uncontroverted facts that gave rise to the present controversy:

> "Petitioner is a domestic corporation composed of American and Filipino stockholders. In the years under review, it was engaged in the plantation of rice, corn and coconut and cattle raising, all situated in Siari, Sindangan, Zamboanga del Norte.

It appears that Mr. John Rocmer, the president of the corporation, being an American, was in continuous hiding during the Japanese occupation. To protect the interest of the corporation, particularly its cattle, Mr. Filemon Lucasan, who owned a cattle ranch adjacent to that of petitioner's, was appointed overseer. After the war, petitioner discovered that practically all its cattle were found in the ranch of Mr. Filemon Lucasan and forthwith demanded the return thereof. Mr. Lucasan, contending that the cattle belonged to him and not to petitioner, filed an action for recovery with damages in the Court of First Instance, Zamboanga del Norte.* After due hearing, the court rendered its decision thereon on June 30, 1952, the dispositive portion of which reads as follows:

> "Adjudicating to the Siari Valley all the cattle that may be found in the cattle ranch of Filemon Lucasan, specially the 321 heads that had been entrusted to his care as receiver or trustee of this Court, and ordering the defendant to deliver to the plaintiff all said cattle or their value amounting to ₱40,000.00 to pay damages to the Siari Valley Estate for the 400 heads of cattle that he sold since 1946 up to the date of the trial at the rate of ₱100.00 per head or ₱40,000.00, plus interest at the rate of 6% from the date of the trial of this case in January, 1951 and to pay the costs of the proceedings",

and the aforesaid decision was affirmed on appeal by the Supreme Court on August 31, 1965 in G.R. No. L-7046 (pp. 59-64, BIR records.)

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*Please see Memorandum dated June 15, 1970 of the Revenue District Officer for the Regional Director, Region No. 20, Zamboanga City, (pp. 50-52, BIR records).

As Mr. Lucasan was then in financial distress and unable to pay the ₱40,000.00 representing the 400 heads of cattle he sold and the interest thereon amounting to ₱32,000.00, or a total of ₱72,000.00, an amicable settlement was formulated whereby Mr. Lucasan would liquidate the aforestated amount of ₱72,000.00 in six (6) annual installments at the rate of ₱12,000.00 per installment. In accordance with the foregoing agreement, petitioner received the installments for 1965, 1966 and 1967 which it duly reported as income for those years and paid the corresponding taxes thereon.

It is the position of respondent, however, that the ₱40,000.00 awarded to petitioner by the trial court represented the value of the 400 heads of cattle absconded by Mr. Lucasan and was, therefore, merely a return of capital. What constitutes income subject to tax is the 6% interest awarded to petitioner in the form of damages which, as computed, amounted to ₱32,000.00. And considering that petitioner uses the accrual method of accounting, the entire ₱32,000.00 should be declared as income in 1965 on the basis of the Supreme Court decision dated August 31, 1965, entitled "Siari Valley Estates, Inc. vs. Lucasan", G.R. No. L-7046 (p. 1, Memorandum for Petitioner). Consequently, the taxpayer had an underdeclaration for 1965 in the amount of ₱20,000.00, because it had already previously reported the amount of ₱12,000.00 (p. 55, BIR records). For taxable years 1966 and 1967, it included in its returns the installments of ₱12,000.00 received per year, thus overpaid its income tax in the amounts of ₱2,563.00 and ₱2,576.00, respectively.

Based on the above findings, the deficiency assessment in question was issued. On September 8, 1971, a warrant of levy on real property was issued, which was duly served on petitioner on September 14, 1971 (p. 36, BIR records). In a letter dated April 2, 1971, and reiterated by another letter, dated September 17, 1971 (pp. 30-33, BIR

> records), petitioner protested the assessment. The protest was denied by respondent in a letter of the Regional Director in Zamboanga City dated October 20, 1971 (p. 28, BIR records). Petitioner further insisted for a reconsideration of the assessment (pp. 26-27, BIR records). Finally, respondent, in his letter of August 29, 1973 (pp. 18-19, BIR records), denied the aforesaid protest."

It should be added, however, that petitioner filed another petition for reconsideration dated January 12, 1974 of the denial of respondent of its protest which he himself issued and signed under date of August 29, 1973. (Exh. "B", pp. 45-48, CTA records.) Without rendering a decision on such petition, respondent instead issued a warrant of levy to enforde collection of the tax assessed by him which was served on petitioner on August 21, 1974. (Exh. "A", "A-1", p. 44, CTA records.) Hence, this appeal which was filed on September 6, 1974.

If petitioner made its returns on a "cash" basis, it is obvious that it was correct for it included in its returns the installments of ₱12,000.00 actually received per year. On the other hand, if petitioner reported on the "accrual" basis, then we must decide whether or not the income represented by the 6% interest awarded to petitioner in the form of damages amounting to ₱32,000.00 accrued and was includible in gross income in 1965 when the decision of the Supreme Court dated August 31, 1965, in "Siari Valley Estates, Inc. v. Lucasan," G.R. No. L-7046, was rendered and probably entered.

Wittingly or unwittingly, petitioner does not seem to know whether it kept its books and made its returns on an accrual or cash basis, although its arguments proceed on the assumption that it is on the cash basis. (See pp. 95-96, CTA records.) Respondent says in his memorandum "that petitioner uses the accrual method of accounting" (pp. 88, CTA records) and this is borne out by the reports of his examiners who investigated the books and income tax returns of petitioner. The income tax returns filed by petitioner during the years in question (see BIR records) state categorically that such returns are made on the basis of accrued income and expenses. For the purpose of this action, we will accept that petitioner kept its books and made its returns on the accrual basis of accounting. Consequently, the principal problem is the time when the income - the amount of ₱32,000.00 representing interest awarded to petitioner in the form of damages-accrued.

This brings us to the definition of the word "accrue". The ordinary law dictionary meaning is "to grow to; to be added to; to become a present right or demand; to rise, to happen, to come to pass." (1 Bouv. Law Dic. (Rawle's Third Rev. 111.) In C.J.S., Accrued, p. 761, it is said: "Accrued, as the past tense or preterit of the verb, has been defined as meaning: Acquired; arose, became due; became vested; came into existence; fell due; has arisen; made or executed; matured; occurred; received; vested; was created; was incurred; was in existence." (See H. Leibes & Co. v. Commissioner of Internal Revenue, (90 F.(2d) 932.) But such a general defenition must be considered in connection with the use of the word. In other words, what is the meaning of the words "income accrued" as used with reference to income tax returns?

Neither the Income Tax Law nor Revenue Regulations No. 2 defines or provides when income accrues. In Lucas v. North Texas Lumber Co., 281 U.S. 11, 74 L.Ed. 668, it is held that income does not accrue until there is "unconditional liability" on behalf of a party to pay it to the taxpayer. In Continental Tie & L. Co. v. United States, 286 U.S.

290, 76 L.Ed. 1111, it is indicated that income accrues, when there is a "right to payment." In North American Oil Consol. v. Burnet, 286 U.S. 417, 72 L.Ed. 1197, it is stated that "If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent." In Spring City Foundry Co. v. Commissioner, 292 U.S. 182, 78 L.Ed. 1200, it is said: "Keeping accounts and making returns on the accrual basis, as distinguished from the cash basis, import that it is the right to receive and not the actual receipt that determines the inclusion of the amount in gross income. When the right to receive an amount becomes fixed, the right accrues." In United States v. Safety Car Heating & Lighting Co., 297 U.S. 88, 80 L.Ed. 500, it is indicated that income accrues when the liability is uncontested and certain.

In Lichtenberger-Ferguson Co. v. Welch (C.C.A.9) 54 F.(2d), 570, it was held that:

> "Under the accrual system of accounting where an item is definitely ascertained as to its amount, and acknowledged to be due, it has 'accrued'. To quote from the decision of the United States Board of Tax Appeals in the case of Appeal of Clarence Schock, 1 B.T.A. 528. 'Under such system of accounting receipt of income-actual or constructive- is not essential to constitute income within the statutory definition of income. Under an accrual system of accounting one accrues income, he does not receive it. Under the receipts and disbursements method, one receives income and does not accrue it."

In addition to these cases are those dealing with the time of accrual of deductions, such as taxes, expenses, losses, and depreciation. In United States v. Woodward, 256 U.S. 632, 65 L.Ed. 1131, it is said that a deduction accrued when it "became due." In United States v. Anderson, 269 U.S. 422, 70 L.Ed., 347, it is held that a deduction accrues when all the events have occurred "which fix the amount of the tax and determine the liability of the taxpayer to pay it." In American National Co. v. United States, 274 U.S. 99, 71 L.Ed. 946, it is indicated that a deduction is accrued when it is "incurred." In United States v. S.S. White Dental Mfg. Co. 274 U.S. 398, 71 L.Ed. 1120, it is said that losses "which are fixed by identifiable events" are accrued. In Weiss v. Wiener, 279 U.S. 333, 73

L.Ed. 720, it is said that a "loss must be actual and present, not merely contemplated as more or less sure to occur in the future." In Lucas v. American Code Co. 280 U.S. 445, 74 L.Ed. 538, 67 A.L.R. 1010, it is said: "Generally speaking, the income tax law is concerned only with realized losses, as with realized gains." See, also Burnet v. Logan, 283 U.S. 404, 75 L.Ed. 1143; Burnet v. Huff, 288 U.S. 156, 77 L.Ed. 670.

From the above expressions, it is apparent that the general definition of "accrued" is limited when taken in connection with income returns. We may conclude that income has not accrued to a taxpayer until there arises to him a fixed or unconditional right to receive it. (H. Liebes & Co. v. Commissioner of Internal Revenue, 90 F.(2d) 932.)

So far, only the right to receive has been considered. Must we also consider the prospect of realization on that right by the taxpayer? In other words, when the right to receive arises, should the fact that the right is or is not collectible be taken into consideration in determining whether income has accrued? We believe that no income accrues unless there is a reasonable expectancy that the right will be converted into money or its equivalent. Commissioner v. Brown (C.C.A. 1) 54 F.(2d) 563; Corn Exchange Bank v. United States (C.C.A.2) 37 F.(2d) 34; Automobile Ins. Co. v. Commissioner (C.C.A.2) 72 F.(2d) 265. Commissioner v. Brooklyn R.S. Corp. (C.C.A.2) 79 F.(2d) 833, 834; 1 Paul & Mertens, Law of Federal Income Taxation, 557, 11.73. See, also, American Cigar Co. v. Commissioner (C.C.A.2) 66 F.(2d) 425, certiorari denied 290 U.S. 699, 78 L.Ed. 601; Helvering v. Russian Finance & Construction Cor. (C.C.A.2) 77 F.(2d) 324, 327.

"The complete definition would therefore seem to be that income accrues to a taxpayer, when there arises to him a (1) fixed or unconditional right to receive it, if (2) there is a reasonable expectancy that the right will be converted into money or its equivalent. (H. Liebes & Co. v. Commissioner of Internal Revenue, *supra*.)"

Now going to interest which is the income item involved in the case at bar, interest is ordinarily accruable when the right to receive it is fixed, and not when it is actually received; but that it is not accruable as long as a reasonable doubt exists as to the amount that is collectible by reason of the financial condition or insolvency of the debtor. (Spring City Co. v. Commissioner, 292, U.S. 182, 54 S.Ct. 64; H. Liebes & Co. v. Commissioner, 9 Cir. 90 F.2d 932; Corn Exchange Bank v. United States, 2 Cir., 37 F.2d, 34; Jamaica Water Supply Co. v. Commissioner, 2 Cir., 125 F.2d. 512; Clipton Mfg. Co. v. Commissioner, 137 F.2d. 290.) Bearing this rule in mind, it seems clear that the interest in the entire amount of ₱32,000.00 awarded to petitioner in form of damages was not entirely accruable in 1965 when the decision of the Supreme Court in the Siari Valley Estates case was rendered.

The records show that the collectibility of the entire item was still open to reasonable question. As a matter of fact, as stated by respondent himself, Mr. Lucasan was then in such "financial distress and unable to pay the ₱40,000.00 representing the 400 heads of cattle he sold and the interest thereon amounting to ₱32,000.00, or a total of ₱72,000.00", that "an amicable settlement was formulated whereby Mr. Lucasan would liquidate the aforestated amount of ₱72,000.00 in six (6) annual installments at the rate of ₱12,000.00 per installment." And "In accordance with the foregoing agreement, petitioner received the installments for 1965, 1966 and 1967 which it duly reported as income for those years and paid the corresponding taxes thereon." (p. 88, CTA records.) The collectibility of the item was therefore established beyond all reasonable doubt in the years 1965, 1966, 1967 (and other succeeding years) in accordance with the terms and conditions of the amicable settlement entered into by petitioner and Mr. Lucasan. It was only then that the income for each year accrued to petitioner when there arose to petitioner a fixed or unconditional right to receive it, coupled with a reasonable expectancy that the right would be converted into money or or its equivalent.

Accordingly, the assessment of respondent dated February 25, 1971 against petitioner Siari Valley Estates, Inc., for deficiency income tax for 1965 and 1968 in the amounts of ₱5,041.07 and ₱101.47, respectively, cannot be sustained. The warrants of levy on real property issued and which were duly served on petititoner on September 14, 1971 and August 21, 1974 are hereby declared without force and legal effect.

WHEREFORE, the decision appealed from should be as it is hereby reversed. No costs.

SO ORDERED.

Quezon City, October 18, 1976.

Amante Filler
AMANTE FILLER
Associate Judge

WE CONCUR:

Estanislao R. Alvarez
ESTANISLAO R. ALVAREZ
Presiding Judge

Roaquin
CONSTANTE C. ROAQUIN
Associate Judge