REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

MARIETTA KALAW, INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 2346

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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

DECISION

This is an appeal from the decision of respondent Commissioner of Internal Revenue assessing against and demanding from petitioner the amount of ₱7,457.60 as deficiency income tax for the year 1961.

Petitioner is a corporation duly organized and existing under the laws of the Philippines. On April 16, 1962, it filed its corporate income tax return for the taxable year 1961. As shown in its income tax return, petitioner deducted, among others, from gross income contributions to the Mindoro Farm of ₱110.00 and interest expense in the amount of ₱48,350.65.

On June 26, 1963, respondent ordered the investigation of petitioner's books of accounts and other accounting records for 1961, including all

(84)

unverified books of accounts in prior years for income tax purposes. Examiner Federico G. Doria, who finally conducted the investigation, rendered a report that petitioner was not entitled to deduct ₱110.00 contribution to the Mindoro Farm and the amount of ₱29,483.93 as interest, and, hence, should be made liable for deficiency income tax in the amount of ₱7,457.60 for the taxable year 1961. Accordingly, Acting Regional Director V. Z. Lasquety, Region No. 6 of the Bureau of Internal Revenue, assessed against and demanded from petitioner the amount of ₱7,457.60 as deficiency income tax for 1961, based upon the following computation:

Net income disclosed by the return		₱867.03
Unallowable deductions & additional income:		
Contribution-Mindoro Farm (Operation during the year shows a net loss)	₱110.00	
Interest expense which should be borned by Stockholders Loan Receivable equal to the rate of interest on bank loan (Overdraft) in favor of the corporation	₱ 29,483.93	
Total adjustments		29,593.93
Net income as per investigation		₱ 28,726.90
Less: Personal and Additional exemptions . . .		- - - -

Amount subject to tax	₱28,726.90
Income tax due thereon	6,320.00
Less: Tax due per return previously assessed or paid	none
Balance	6,320.00
Surcharge-fifty or twenty-five percent	- - -
Interest	1,137.60
Compromise	- - -
TOTAL DEFICIENCY TAX DUE AND COLLECTIBLE	₱ 7,457.60

As can be seen from the above, the deficiency assessment resulted from the disallowance of (1) the contribution to the Mindoro Farm of ₱110.00; and (2) interest in the amount of ₱29,483.93, which is allegedly a part of the interest paid on an "overdraft" secured by petitioner Marietta Kalaw, Inc. from the Philippine Trust Company in the amount of ₱560,234.88, portion of which was granted as loans to its stockholders and employees. The amount of ₱29,483.93 as interest was disallowed by respondent as interest deduction, out of the total interest claimed in the sum of ₱48,350.65, because the "overdraft" of ₱560,234.88 was not entirely utilized by petitioner in its business, or was not wholly a business expense, but was used for the personal benefit of its stockholders and employees.

86

This amount of ₱29,483.93 was arrived at by the respondent's Examiner Doria first finding out how much of the amount of ₱560,234.88 acquired by petitioner as "overdraft" from the Philippine Trust Company was loaned individually to said stockholders and employees. As shown by his worksheets used during his investigation, Examiner Doria recorded all the monthly balances of the loans granted individually to the stockholders and employees for the period from January to December, 1961, inclusive, and applied on each individual monthly balances an 8% interest, arriving at the interest of ₱29,483.93, as follows:

Stockholders with Loan Receivable and from employee.	Amount Computed Per monthly Balances
1. Heirs of M. Kalaw	₱ 240.00
2. Marietta T. Kalaw	14,478.51
3. Augusto Kalaw	3,256.68
4. Lydia Kalaw	180.33
5. Erlinda Illusorio	3,257.67
6. Potenciano Illusorio	600.00
7. Edgardo Kalaw	3,128.27
8. Maximo Kalaw Jr.	4,183.28
9. Macaria Manguiat	159.19
Total	₱ 29,483.93

This amount of ₱29,483.93 was later considered by Examiner Doria as "Interest expense which should be borned by Stockholder's Loan Receivable equal to the rate of interest on bank loan (overdraft) in favor of the corporation." In other words, the amount of ₱29,483.93 represents the interest computed by BIR Examiner Doria on the amount of loans granted individually to petitioner's stockholders and employees, and which he claims to properly appertain to said stockholders and employees, and should not be claimed by, or allowed to, petitioner as interest deduction.

In a letter dated March 3, 1967, received by respondent's BIR Regional District No. 6 on March 6, 1967, petitioner protested the deficiency income tax assessment of ₱7,457.60 and requested for cancellation and withdrawal thereof on the ground that the interest in the computed amount of ₱29,483.93 should be allowed as deduction because all the requisites necessary for its allowance are present, namely: (1) that there was in indebtedness; (2) that the interest claimed as deduction was paid or accrued within the taxable year; and (3) that the indebtedness is its own indebtedness, and cited as authority the case of Carlos Palanca Jr. vs. Commissioner of Internal Revenue, CTA Case No. 571, December 2, 1959.

In a letter dated April 4, 1967, the Acting Regional Director, V.Z. Lasquety, requested peti-

98

tioner, through its counsel, to submit evidence showing that the interest claimed are business expenses in connection with the productions or earning of petitioner's income. The Acting Revenue Director, in a letter dated August 22, 1967, reiterated his previous request for the petitioner to present evidence to show that the interest claimed by it as deduction is a business expense, otherwise he will be constrained to enforce the collection of the deficiency income tax through remedies provided by law and without further notice.

In a letter dated August 5, 1968, petitioner requested for reinvestigation and presented a waiver of the statute of limitations which was accepted by respondent's Acting Regional Director V. Z. Lasquety. The request of petitioner for a reinvestigation was granted in a memorandum of the Acting Assistant Regional Director dated October 10, 1968. On November 18, 1968, after counsel for petitioner had failed to produce the latter's records, or produce evidence against the assessment, Examiner A. B. Vergara recommended the collection of the assessment in the total amount of ₱7,457.60. On December 17, 1968, the Acting Regional Director

V.Z. Lasquety wrote a letter to petitioner, the pertinent portion of which states:

> Apparently, your counsel thru Attorney Erezo, has been notified and informed in order to produce the records or any other evidence to counteract the said assessment but which up to now we have not been favored with a reply. In effect, it is also understood that you admit the correctness of the findings and assessment which has been made for the said year. Therefore, this Office, has no other alternative but to concur with the previous findings and recommendation of our examiner, and accordingly proceed and enforce the collection thereof through the legal remedies provided for by law.
>
> On account thereof, it is requested that you pay the sum of ₱7,457.60 plus increments incident to late payment, within ten (10) days upon receipt hereof <u>in order that your case may be considered closed and terminated</u>. (Underscoring ours.)

On August 27, 1971, Acting Regional Director Lasquety requested for the payment of the deficiency tax assessment. Finally, in a letter dated October 12, 1971, Acting Regional Director Lasquety, formally denied petitioner's protest and urged it <u>"for the last time"</u> to settle its deficiency income tax liability in the amount of ₱7,457.60 within ten (10) days from receipt "<u>in order that this case may be closed</u>" and threatened to enforce the same by judicial action without further notice in case of its failure to do so. Pertinent portion of said letter reads as follows:

> In view thereof, it is requested for the last time that you settle your abovementioned tax liability, plus the increment penalty incident to late payment within ten (10) days from your receipt hereof, in order that this case may be closed; otherwise, this Office will be constrained to enforce the collection thereof through the warrant of distraint and levy and/or judicial action without further notice. (Emphasis ours.)

Consequently, on November 11, 1971, petitioner appealed to this Court.

The issues submitted for resolution to this Court are:

> (1) Whether or not this Court has jurisdiction to take cognizance of the instant appeal; and
>
> (2) Whether or not the amounts of ₱29,457.60 and ₱110.00 as interest and contribution deductions, respectively, claimed by petitioner are legal and justified.

With respect to the first issue of jurisdiction, respondent maintains that this Court cannot take cognizance of the instant case because the appeal was filed more than 30 days from receipt of alleged decision of December 17, 1968, signed by Acting Regional Director V.Z. Lasquety, a duly authorized subordinate official. On the other hand, petitioner contends that it has not received the alleged letter-decision dated December 17, 1968 and, therefore, there is still no decision to speak of. It urged us that the final decision is that letter dated October 12, 1971 and that having received the same on October 28, 1971, the petition for review was filed on time.

We agree with petitioner that this Court has jurisdiction over the appeal. There is nothing in the records which will show how, where and when the alleged letter-decision of Acting Director V.Z. Lasquety dated December 17, 1968 was sent to petitioner. Inasmuch as it was respondent Commissioner of Internal Revenue who raised the question of jurisdiction, it is, therefore, incumbent upon him to show that alleged letter-decision was signed, duly dated and sent by mail. In the absence of an evidence showing that it was sent by mail and received by petitioner, we are inclined to hold that it was neither sent, to, nor received by the latter. Hence, the alleged decision of Acting Regional Director Lasquety dated December 17, 1968 cannot be considered as the final decision for purposes of this appeal. But even assuming that said letter was sent and received by petitioner, a scrutiny of the said letter shows that it is not the final decision contemplated in Section 7 of Republic Act No. 1125 because it does not have the characteristic of finality. It has been held that a decision to be appealable must contain the element of finality.[1] In this case, said letter of December 17, 1968 does not possess the element of finality because the last paragraph of said letter requested petitioner to pay within ten (10) days in order that the "case may be considered closed and terminated." This letter conveys the idea that Acting Director Lasquety still holds the case open and may still reconsider upon further request the tax assessment against petitioner.

And we are more inclined to believe that the appealable decision from which petitioner could appeal, and from which it did appeal to this Court, is that letter of Acting Director Lasquety dated October 12, 1971 because it is this letter that

---

[1] Gibbs vs. Comm. of Int. Rev., CTA Cases Nos. 1718 and 1719, December 27, 1969, unappealed, St. Stephen's Association, et al. vs. Coll. of Int. Rev., 104 Phil. 314,317.

had the element of finality, which we quote in part once more for emphasis:

> In view thereof, it is requested for the last time that you settle your abovementioned tax liability, plus the increment penalty incident to late payment within ten (10) days from your receipt hereof, in order that this case may be closed; otherwise, this office will be constrained to enforce the collection thereof through the warrant of distraint and levy and/or judicial action without further notice. (Underlining supplied.)

In essence, and as can be gathered from the context of this letter, when respondent's BIR Acting Regional Director Lasquety said in the last portion thereof that he will enforce the collection of the assessment by warrant of distraint and levy and/or judicial action without further notice, he definitely advised petitioner that this decision is final and that he will not entertain any more delay in the payment of the deficiency tax. We note, however, that petitioner was not able to show when the aforesaid letter was actually received by it. Assuming that the said letter was sent by ordinary mail in Manila where the offices of the Acting BIR Director is located, on the same day it was prepared or dated on October 12, 1971, petitioner is deemed to have received the decision on October 18, 1971, which is after the expiration of five (5) days from the date of mailing, in accordance with the provisions of Section 8, Rule 13 of the Rules of Court. From the presumed receipt on October 18, 1971 of the decision to the date of filing of the petition for review on November 11, 1971, only 25 days was consumed out of the 30-day period of appeal provided in Section 11 of Republic Act No. 1125. Obviously, the petition for review was, therefore, seasonably filed.

Having disposed of the jurisdictional question, we will now consider the issue as to whether or not the claimed deductions are legal.

With respect to the amount of ₱29,483.93, which is actually part of that interest which petitioner had paid to the Philippine Trust Company on an "overdraft" acquired, portion of which was subsequently loaned to its stockholders and employees, petitioner strongly urged its deductibility on the basis of the decision in the case of Carlos Palanca, Jr. vs. Comm. of Int. Rev., CTA Case No. 571, December 2, 1959, affirmed in G. R. No. L-16626, promulgated on October 29, 1966, wherein it was held that the interest expense is deductible from the gross income when the following requisites are present, namely: (1) that there was an indebtedness; (2) that the interest claimed for deduction have been paid or accrued within the year; (3) that the

95

indebtedness is that of the taxpayer. Petitioner claims that these requisites required for the interest's deductibility being present in the instant case, it is legal and justified. We find this claim to be meritorious and we find the case of Carlos Palanca vs. Comm. of Int. Rev., supra, applicable in the instant case.

Under paragraph 1 of the "Agreement for credit in Current Account," entered into between petitioner and the Philippine Trust Company dated May 27, 1960, the latter granted to petitioner "a loan by way of credit in current account" in the amount of only Six Hundred Thousand (₱600,000.00), out of which the amount of ₱560,234.88 was actually and undisputedly withdrawn, credited and carried in the Philippine Trust Co. books as an "overdraft or credit to current account" of petitioner with interest at 8% payable monthly, computed upon the daily debit balances of petitioner as will be shown in the bank's books. This arrangement between petitioner and the said bank was what is normally and strictly understood as a "line of credit." A "line of credit" is actually and generally understood, in banking as well as in commercial practice, as a loan, without a collateral, upon which a businessman is allowed to borrow in periodic amounts to meet short-term obligations and is charged a normal interest for the period for which the money is actually borrowed.[2]

The arrangement between petitioner and the Philippine Trust Co. was also denominated by them as "overdraft," and was so understood by respondent. In the true sense of the term, an "overdraft" is a truly loan to a depositor. But strictly speaking, an "overdraft" results from the drawing by a depositor by check for more than the balance on deposit in his account with the bank, in which the bank may elect to render its customer a service and pays the check, and the amount to the extent overdrawn, is considered a forced loan to the depositor for which

---

[2]Carl A. Dauten etc., Principles of Finance, 3rd Ed. (Cincinnati, USA: South-Western Publishing Co.), pp. 167, 170-171; Gregorio S. Miranda, Ph. D., Essentials of Money, Credit and Banking, Rev. Enlarged Ed. (Manila: L & G Business House, 1973), pp. 296-297.

an interest is then charged.[3]

Definitely, based upon the above authorities, the borrowing of the sum of ₱560,238.88 by petitioner is rightly classified as a "line of credit", and not an "overdraft" as shown by their agreement for credit. But whether it was on a line of credit or an overdraft, the amount of ₱560,234.88 acquired was nonetheless a loan and the interest charged and received by the Philippine Trust Co. as interest thereon, of which the amount of ₱29,483.93 disallowed by respondent is definitely only a portion of the interest paid upon that entire loan obligation.

There is no dispute that after petitioner had secured the said "overdraft" or "credit line" from the Philippine Trust Co. in the actual amount of ₱560,234.88, upon which an interest of 8% was paid thereon to the bank, petitioner had later loaned a portion of this amount to its stockholders and employees at a lower rate of 6% interest, thereby losing in the process 2% interest which was borne by it.

---

[3] Gregorio Miranda, ibid; Jerome B. Cohen, etc., Personal Finance Principles and Case Problems 3rd Ed. (Illinois, USA, Richard E. Irwin, Inc., 1964), pp. 184-185; Carl A. Dauten, op. cit., p. 167.

The lending by petitioner of a portion of the amount of ₱560,234.88 to its stockholders and employees for which it earned only 6% interest in the transactions, does not preclude the deductibility of the 8% interest in the amount of ₱29,483.93, already paid or incurred by petitioner, equivalent to the interest charged by the bank on the loan (line of credit or overdraft) under the provisions of Section 30 (b)(1) of the National Internal Revenue Code, which reads, as far as material, as follows:

> Sec. 30. Deduction from gross income.- In computing net income there shall be allowed as deduction -
>
> x x x x x x x x x x x
>
> (b) Interest
>
> (1) In general.- The amount of interest paid within the taxable year on indebtedness, x x x.

Section 30 (b)(1) of the Tax Code allowing a deduction of interest from gross income of a taxpayer, is a provision practically lifted from Section 23 of the Revenue Acts of 1932 and 1934 of the United States,[4] and this "sta-

[4]Edward C. Kohlsaat v. Comm. of Int. Rev., 40 BTA 528, 532, citing Sec. 23(b) of Revenue Act of 1934 of the U.S., which provides in part, as follows:

> x x x x. In computing net income there shall be allowed as deductions
>
> x x x x
>
> (b) Interest.- All interest paid or accrued within the taxable year on indebtedness.

is a provision substantially similar to Sec. 30 (b)(1) of the NIRC, cited above.

tutory provision allowing deduction of interest on indebtedness means interest on an obligation of the taxpayer claiming it."[5] In plain words, under this provision, the interest paid or incurred on a loan obligation can definitely be claimed as deduction from gross income by the taxpayer. It is as simple as that. The interest in question is doubtless one that was paid or incurred on a principal and personal loan liability of petitioner to the Philippine Trust Company on what may be considered either as a "line of credit" or "overdraft" and, therefore, can be claimed by it as allowable deduction from its gross income;[6] and the obligation of petitioner to said bank on such loan is not the personal and principal loan obligation or liability of the stockholders and employees to the said bank, as respondent would want to appear, in effect, before us.

---

[5] Edward C. Kohlsaat v. Comm. of Int. Rev., op. cit.; Chester A. Sheppard v. Comm. of Int. Rev., 37 BTA 279, 281, applying Sec. 23(b) of the Revenue Act of 1932 of the U.S., which provisions allows as deduction "interest paid or accrued within the taxable year on indebtedness." (Underlining ours.)

[6] See Frieda Hempel, 47,183 PHTC Memo; Rainbow Gasoline Corp. v. Comm. of Int. Rev., 31 BTA 1050, 1060; A. Backus Jr. & Sons v. Comm. of Int. Rev., 6 BTA 590, 592.

If there is any liability of the stockholders and employees on their respective loans for which they have paid an interest of 6%, it is to their lender, or petitioner herein, to whom they were individually indebted and the interests they have paid on their individual loans can be claimed by them as deductions in their respective individual income tax returns. And the return to petitioner of the 6% interests, paid by the stockholders and employees to petitioner on the loans given to them, therefore, will not give rise to the disallowance of the interest of ₱29,483.93 paid by petitioner to the bank on the overdraft, equivalent to 8% interest charged against the monthly balances of the individual loans to the petitioner's employees and stockholders. Were we to take the stand of respondent and disallow the interest claimed to the extent of the sum of ₱29,483.93, that would have the effect of disregarding the legal rights of the parties, which is the right of the petitioner, on one hand, to lend money at a legal rate of interest, and the individual stockholders and employees, on the other hand, to borrow money at an interest which contracting parties are recognized by law as personalities independent of and distinct from one another.

While the Government it is true may have an interest in all taxable transactions between contracting parties, and qualified to question their validity or ligitimacy whenever necessary to block tax evasion, and disregard said transactions when illegal[7], the loans, however, granted by petitioner to its employees and stockholders were not invalid or illegal. The evidence at hand do not show that petitioner had intended, by granting said individual loans, to evade taxes to the jeopardy or prejudice of the Government. What may perhaps be unlawful would be, if petitioner did not recognize in its 1961 income tax return the 6% interest income it had earned from the individual loans granted to its stockholders and employees, but there is no indication towards this end, and this question was not brought before us. These individual loan transactions between petitioner and its employees and stockholders cannot, therefore, be legally disregarded. In one case in

---

[7] Antonio Medina vs. Coll. of Int. Rev., CTA Case No. 129, November 26, 1958; aff'd in Antonio Molina vs. Collector of Int. Rev., et al. G.R. L-15113, Jan. 28, 1961, 1SCRA 302,307.

10

the U.S., where a divorced wife had actually paid the interest on a personal mortgage debt, not a business debt, a loan obligation, and a liability, of the divorced husband, who is a lawyer by profession, the interest paid by the divorced wife but claimed by said divorced husband as interest deduction in his return was held allowable as he (the divorced husband) was the one personally and principally liable for the mortgage debt.[8]

In this particular case at bar, the interest having been paid by petitioner on its personal loan obligation to the Philippine Trust Company which was as aforesaid on a "line of credit" or an "overdraft," such interest is clearly deductible from gross income. The interest to be deductible need not be one that is paid, or incurred, only upon a loan obligation secured for business purposes, since, as shown by the above cited authorities, interest is deductible under Section 30(b)(1) of the National Internal Revenue Code, whether the debt was secured for business or for personal purposes.

---

[8] Edward C. Kohlsaat, op. cit., pp. 528,532-534.

As in the last throes of the struggle, respondent finally asserted that the non-deductibility of the interest in question can be based upon the fact that there were no records which will support the payments of the interests. This assertion can hardly be considered meritorious inasmuch as there was an actual finding by Examiner Federico Doria that there was an overdraft incurred by petitioner from the Philippine Trust Co. of which the ₱29,483.93 computed interest is only part of that large interest recognized by respondent as having been paid by petitioner to the bank on the said overdraft, and that the only reason for his disallowance of the deduction is because it is not a business expense, or that it was paid or incurred for the "benefit of the stockholders and employees."[9] This last ground asserted by respondent counsel in defense of his disallowance seems to us to be just an afterthought since this was not asserted by him even during the administrative investigation.

---

[9]BIR rec., p. 32.

Petitioner also claimed a deduction in the amount of ₱110.00 as contribution to the Mindoro Farm but which was disallowed by respondent. In denying the claimed contribution deduction, respondent based his action on the fact that petitioner, having incurred a net loss in its farming business in the year 1961, it cannot have been possible that the latter made that contribution.[10] We find this contention equally not worthy. The disallowance of contribution could not be validly based simply upon the fact of the existence of a net loss to the business of petitioner. In order to be valid, the disallowance should be based on the fact that there was not in fact any contribution.

The records or worksheets[11] of respondent actually show that this contribution was made by petitioner in the year 1961 during the time that the Mindoro Farm to which it was then given was apparently still in operation. It is not convincingly logical for respondent to even suppose that since petitioner had suffered a net loss in its farm business operation at the end of the taxable year 1961, it would nigh be impossible that a

---

[10]BIR. REC., p. 32.

[11]BIR. rec., p. 23.

contribution of ₱110.00 have been made by petitioner. Not only is the amount of contribution claimed very small, but this amount can certainly be deductible even if petitioner's business have suffered a loss at year's end as long as it was actually been contributed by it. Petitioner's claim for deduction of the sum of ₱110.00 as contribution should, therefore, be allowed.

WHEREFORE, the decision appealed from should be, as it is hereby, reversed.

Without pronouncement as to costs.

SO ORDERED.

Quezon City, December 8, 1976.

CONSTANTE C. ROAQUIN
Associate Judge

WE CONCUR:

ESTANISLAO R. ALVAREZ
Presiding Judge In the result.

Amante Filler
AMANTE FILLER
Associate Judge In the result.