

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PHILIPPINE REFINING COMPANY,
Petitioner,

- versus -

C.T.A. CASE NO. 4408

COMMISSIONER OF INTERNAL
REVENUE,

Respondent

x - - - - - x

2/3/93

D E C I S I O N

Petitioner, a corporation duly organized and existing under the laws of the Philippines, where it is engaged in business, was assessed by the respondent Commissioner of Internal Revenue for alleged deficiency income tax for the year 1985, in the sum of P1,892,584.00, computed as follows:

Deficiency Income Tax

Net income per investigation		P197,502,568.00
Add: Disallowances		
Bad Debts	P 713,070.93	
Interest Expense	<u>2,666,545.49</u>	<u>3,379,616.00</u>
Net Taxable Income		<u>P200,882,184.00</u>
Tax due thereon		<u>P 70,298,764.00</u>
Less: Tax paid		<u>69,115,899.00</u>
Deficiency income tax		<u>P 1,182,865.00</u>
Add: 20% interest (60% max.)		<u>709,719.00</u>
Total Amount Due & Collectible		<u><u>P 1,892,584.00</u></u>

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The assessment was timely protested by the Petitioner on April 26, 1989 on the ground that the bases of the assessment, namely: "interest" and "bad debts" were both allowable and legal deductions. However, instead of acting on the said protest herein Respondent issued a Warrant of Garnishment and served said warrant against Petitioner's bank deposits with the City Trust Buendia Branch, Makati, Metro Manila, on November 15, 1989. The issuance of said warrant was considered by the Petitioner as a denial of its protest appealable to this Court following the doctrine enunciated in *Algue vs. Commissioner*, CTA Case No. 1620, January 16, 1968.

Hence, this Petition for Review.

The only dispute or issue involved in this case is whether or not the disallowance by the Respondent of the following deductions are legal and justified:

- | | |
|---------------------|---------------|
| a) Interest Expense | P2,666,545.19 |
| b) Bad Debts | 713,070.93 |

Petitioner contended that the foregoing were legitimate expenses incurred in the furtherance of the business operations, hence, allowable as deductible items under Section 29 of the Tax Code.

The Respondent, however, disagreed.

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Out of the total interest of P52,517,118.00 claimed by the Petitioner in its 1985 income tax return, the investigating examiner disallowed P2,666,545.19 "for being unsupported".

In the hearing of January 27, 1992, the examiner, on direct examination testified as follows:

"ATTY. DAVID

Q. A protest was filed by petitioner in this case requesting a re-investigation of the assessment. Was this request referred to you for re-investigation"

A. Yes.

Q. What happened to that re-investigation you conducted? Was there a re-investigation conducted?

A. Yes, I conducted a re-investigation. Actually the original assessment for this case was P22 million. Now they submitted a protest letter, the BIR referred it back to me for re-investigation. Then I studied back the case, then I allowed, most of the assessment was allowed. Only on the assessment for bad debts and interest expense was upheld because I think the other assessments will not hold.

Q. Why?

A. Actually I have not seen the books so ...

Q. Did you ask Ms. Masaganda, the accountant, to produce those documents regarding the

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discrepancies of bad debts and interest expense?

A. I asked them but they explained why it was like that, then I understood that they were correct then I ...

Q. What do you mean they were correct, those interest expense?

A. No, I mean the other assessments.

Q. Did you ask them again to produce those documents to prove that ...

A. Yes, for those interest expense and bad debts.

Q. They were not able to produce those documents?

A. Yes.

Q. Did you submit a report on that?

A. Yes."
(See T.S.N., pp. 12-14)

Thus, the Petitioner, according to the Respondent, is now "estopped from raising new matters which was not touched upon/discussed in the administrative level" (Aguinaldo Industries Corp. vs. Commissioner of Internal Revenue, G.R.L.-29790, February 25, 1982), by belatedly presenting in evidence for the first time before this Court an Alpha List (Exh. "B"), purportedly showing that Petitioner paid additional interests to creditors totalling P2,666,545.19 which was not considered by the examiners during their investigation.

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Such contention failed to convince this Court.

On the contrary, We gave credence to the testimony of Mrs. Guia D. Masaganda, the Financial Accountant of herein Petitioner, during the hearing of this case on October 19, 1990, thus:

"ATTY. LOBRIN:

Q. Now, let's come to the proof of interest that was paid by your corporation in 1985.

Did you submit with the income tax return filed for the year 1985 the 1701B containing a list of creditors to whom interests were paid in 1985?

A. Yes, sir. This is attached to the income tax return we filed in 1985. BIR Form 1701B refers to income payments not subjected to withholding tax.

Q. Will you be able to locate from here?

A. Yes, this one.

ATTY. LOBRIN:

We would like to make it of record that this bunch of papers which I am now handling is the docket or official record of the Bureau of Internal Revenue on this case, deficiency income tax for the year 1985. And on page 195 of this docket appears the BIR Form 1701B submitted for the Calendar Year 1985 which I respectfully request to be marked as Exhibit "A".

JUDGE ROAQUIN:

Mark it.

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(The deputy clerk so marks.)

Q. I am showing to you, Ms. Masaganda, this document marked as Exhibit "A" which is page 195 of the BIR record. What relation has this document, Exhibit "A", with the document which you said you attached to the income tax return of the corporation for 1985 indicating creditors, their addresses and the amounts of interest paid to them by the petitioner?

A. That is the same document we attached to the income tax return we filed with the Bureau of Internal Revenue as required by the law.

(See T.S.N., pp. 5-6)

x x x

Q. Now, the total of this as appearing in Exhibit "A" is P49,972,321.90. This figure I have just read for P49 million plus represents the total of interest paid by your corporation as appearing in this list marked as Exhibit "A".

A. Yes, sir.

Q. Are these the only interests your corporation paid on loans and obligations incurred in connection with the business of the corporation?

A. No.

Q. There are some more not listed in Exhibit "A".

A. Yes.

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Q. Did you report to the Bureau of Internal Revenue those interests which you said are not yet listed in Exhibit "A"?

A. Yes, sir. We submitted a separate alpha list to the Bureau of Internal Revenue because these are the interests paid by the company which were subjected to withholding tax.

Q. Now, let us get this clear.

In Exhibit "A", is itemized interest paid by your corporation, Philippine Refining Company, to numerous banks and lending institutions. In addition to the interests reflected in Exhibit "A" you said your company paid interest also on some other obligations. Do you have document to prove this other interest not included in Exhibit "A"?

A. Yes, sir. I have here the annual return of final income tax withheld submitted to the BIR on January 31, 1986 as required. Together with this is the Alpha list of all income payments subjected to final withholding tax during the year 1985, part of which is the interest portion.

(See T.S.N., pp. 8-9)

x x x"

Hence, the contention of the Respondent that the interest expense of P2,666,545.19 should be disallowed for being unsupported, was belied by the fact that the Alpha List which contained all income payments subjected to final withholding tax during

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the year 1985, part of which was the interest portion, was marked received by the BIR on January 31, 1986 (Exhibit "B").

From the testimony of the same witness of the Petitioner, this Court takes cognizance of the following established facts:

1. That the total interest deducted as expense in the income tax return of PRC for 1985, amounted to P52,517,117.97;
2. That of the said amount of P52,517,117.97, the investigating Examiner allowed only P49,972,321.90, which is the total of the interest listed in BIR Form 1701-B, marked "A";
3. That the Investigating Examiner disallowed the difference between the above two figures (P52,517,117.97 and P49,972,321.90), or a difference of P2,666,545.19; and treated this difference as "unsupported" and disallowed it and made it a basis for the deficiency income tax in question;
4. That the Investigating Examiner did not take up and did not consider as part of deductible interest the additional interest listed in the second document, the Alpha List, marked as Exhibit "B";

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5. That the interest listed in the Alpha List would wipe out the discrepancy of P2,666,545.19; and there could be no more interest disallowance to serve as basis for deficiency income tax assessment; and

6. The Investigating Examiner, admitted all the foregoing except the interest stated in the Alpha List (Exh. "B").

Why, then, did the investigating examiner not consider as deductible expense the interest listed in the Alpha List?

To this question, this Court discredits the confusing and incoherent answer of the investigating examiner, Mr. Edgardo Raquid. First, he testified that he did not see the Alpha List, but on further questioning by the counsel of the Petitioner, he admitted that he saw and examined the same Alpha List. On cross-examination in the hearing of January 27, 1992, Mr. Raquid testified as follows:

ATTY. LOBRIN:

Q. x x x. But what I am after is, another listing included in the alpha list which BIR regulations require to be submitted within one month following the end of the year. You did not see that alpha list containing another separate listing of interest?

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A. But I ask this from the ...

JUDGE ROAQUIN:

No, answer directly the question.

Q. Did you see this?

A. No, sir.

Q. And therefore you did not consider
such payment as part of the
interest payment during the
whole year?

A. No.

(See T.S.N., pp 20-22)

x x x

Q. The Alpha List is the device that
the BIR rules and regulations
provide so that the BIR may
know right away what are those
items subject to withholding
tax that are paid by the
taxpayer, and that is called
the Alpha List?

A. Yes.

Q. And you did not see that alpha list
in your investigation?

A. Yes, I saw it. It's here. This is
the Alpha List. I saw it."

(See T.S.N., p. 29)

We consider the conflicting declarations of
witness Raquid as unreliable. As ruled by the
Supreme Court in the case of Mondragon vs. Court of
Appeals, 61 SCRA 511 (1974), "involving a witness
in contradictions during cross-examination is one
of the recognized modes of impeachment which

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renders the evidence from his lips worthless for both parties. Neither one of his contradictory declarations can be relied upon". Such contradictory declarations fortified Our belief that the witness of the petitioner was the one telling the truth, not only because of such contradictory declarations by witness of respondent but, more so because of the presence of the Alpha List.

Now, we come to the discussion of bad debts. The alleged bad debts are:

Name of Debtor	Amount of Debt	Reason for adjudging the account as Bad Debts
TRADE DEBTORS:		
Remoblas Store	P 11,961.00	The store was totally burned by fire that hit Urdaneta Shopping Complex in November 1984; debtor has no visible assets and collection is very remote;
Tomas Store (Angono, Rizal)	16,842.79	The owners were murdered; no chance of collection;
A F P C E S	13,833.62	Outstanding accounts since 1982/1983; disallowed 2% discount and damaged stocks deducted in advance AFPCES under new management; no chance to collect;
CN Variety Store	10,895.82	Store was hit by fire in Alabang; customer cannot be located;
Petronila Catap (Pet Mini Grocery)	29,098.30	Writ of execution cannot be implemented as customer transferred residence and whereabouts remain unknown;
U'Ren Mart Interprise	10,487.08	Balance of an account; owner of store can no longer be located;

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Esther Guinto (Esther S/S Store)	254,375.54	Customer insolvent and now residing abroad per credit investigation, sheriff's return, postman's return and sales report;
Manuel Orea (Elman Gen. Mdsg.)	34,272.82	Writ of execution cannot be implemented as customer has no leviable assets;
	<u>P381,766.97</u>	

SUNDRY DEBTORS

Aboitiz Shipping Corp.	P 89,483.40	30% discount given on hijacked shipment of P298,278.00;
J. Ruiz Trucking	69,640.34	30% discount on hijacked shipment of P232,134.47;
Renato Alejandro	13,550.00	Balance of account of a separated employee who is now insolvent;
Lucito Sta. Maria (Davao City)	13,772.00	Value of stock shortages due to robbery/holp-up in July 1985;
Craig, Mostyn Pty. Ltd.	23,738.00	Short shipment of tallow; claim was declined by the insurers;
C. Itoh	19,272.22	Short shipment of palm oil; claim against supplier filed in 1982 but remained unacknowledged;
Crocklaan B.V.	77,690.00	Cost of reprocessing a rejected shipment; claim filed in 1982 was declined by supplier;
Enriched Food Corp.	24,158.00	Value of rejected shipment of dried red onions; claim unacknowledged by supplier despite many follow-ups.
	<u>P331,303.96</u>	
T O T A L	<u>P713,070.93</u>	

(See Annex "A", pp. 9-11, CTA rec.)

Out of the sixteen (16) accounts alleged as bad debts, We find that only three (3) accounts have met the requirements of the worthlessness of

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the accounts, hence were properly written off as bad debts, namely:

1.	Petronila Catap (Pet Mini Grocery)	P 29,098.30
2.	Esther Guinto (Esther Sari-sari Store)	254,375.54
3.	Manuel Orea (Elman Gen. Mdsg.)	34,272.82 -----
	T O T A L	<u>P317,746.66</u>

Our statute permits the deduction of debts "actually ascertained to be worthless within the taxable year", to prevent arbitrary action by the taxpayer to unduly avoid tax liability. The requirement of ascertainment of worthlessness requires proof of two facts: (1) that the taxpayer did in fact ascertain the debt to be worthless in the year for which the deduction was sought; and (2) that, in doing so, he acted in good faith. Good faith on the part of the taxpayer is not enough. He must show also that he had reasonably investigated the relevant facts and had drawn a reasonable inference from the information thus obtained by him. (Collector vs. Goodrich International Rubber Co., 21 SCRA 1336, December 26, 1967). The creditor must be able to demonstrate that the debt is not only uncollectible but also appears uncollectible at any time in the

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future. So, where the recovery is merely doubtful, deduction will not be allowed. The following steps should be followed:

1. sending of statements of accounts;
2. sending of collection letters;
3. giving the account to a lawyer for collection; and
4. filing a collection case in court.

All of the foregoing requirements have been satisfied. In fact, the writ of executions issued against the above-mentioned accounts have been returned since they cannot be implemented either because the owner has already transferred residence and his whereabouts unknown or he is insolvent.

With regard to the other accounts, namely:

1.	Remoblas Store	P 11,961.00
2.	Tomas Store	16,842.79
3.	AFPCES	13,833.62
4.	CM Variety store	10,895.82
5.	U'Ren Mart Enterprise	10,487.08
6.	Aboitiz Shipping Corp.	89,483.40
7.	J. Ruiz Trucking	69,640.34
8.	Renato Alejandro	13,550.00
9.	Craig, Mostyn Pty. Ltd.	23,738.00
10.	C. Itoh	19,272.22
11.	Crocklaan B.V.	77,690.00

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12. Enriched Food Crop.	24,158.00
13. Lucito Sta. Maria	13,772.00
T O T A L	<u>P395,324.27</u>

We find that said accounts have not satisfied the requirements of the "worthlessness of a debt". Mere testimony of the Financial Accountant of the Petitioner explaining the worthlessness of said debts is seen by this Court as nothing more than a self-serving exercise which lacks probative value. There was no iota of documentary evidence (e.g., collection letters sent, report from investigating fieldmen, letter of referral to their legal department, police report/affidavit that the owners were bankrupt due to fire that engulfed their stores or that the owner has been murdered, etc.), to give support to the testimony of an employee of the Petitioner. Mere allegations cannot prove the worthlessness of such debts in 1985. Hence, the claim for deduction of these thirteen (13) debts should be rejected.

In view of the foregoing, petitioner's deficiency income tax for the year 1985 is computed as follows:

Net income per return	P197,502,568.00
Add: (disallowed Bad Debt)	<u>395,324.27</u>
Net taxable income per decision	<u>P197,897,892.27</u>

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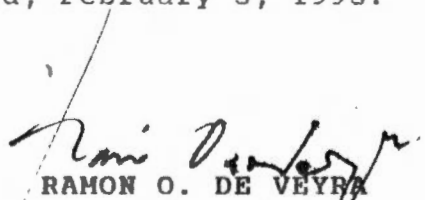
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Income tax due thereon	P 69,264.262.29
Less: Tax already paid	69,115,899.00
Deficiency income tax per decision	P 148,363.29
Add: 20% interest (60% max.)	89,017.97
Total amount due and collectible	P 237,381.26

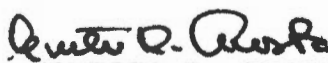
WHEREFORE, the findings of respondent Commissioner of Internal Revenue is hereby modified. Petitioner is ordered to pay respondent the amount of two hundred thirty seven thousand three hundred eighty one pesos and 26/100 (P237,381.26), as deficiency income tax for the year 1985, plus surcharge and interest incident to delinquency, pursuant to the provisions of Sec. 248 and 249 of the applicable Internal Revenue Code, as amended.

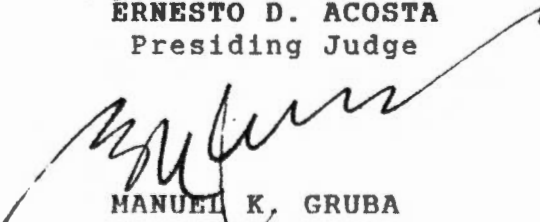
SO ORDERED.

Quezon City, Metro Manila, February 3, 1993.


RAMON O. DE VEYRA
Associate Judge

WE CONCUR:


ERNESTO D. ACOSTA
Presiding Judge

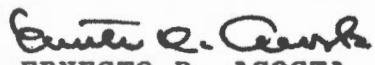

MANUEL K. GRUBA
Associate Judge

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CERTIFICATION

I hereby certify that this decision was reached after due consultation among the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.


ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals