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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

CHAILEASE FINANCE CORPORATION,
Petitioner,

- versus -

C.T.A. CASE NO. 5698

COMMISSIONER OF THE BUREAU OF INTERNAL REVENUE,
Respondent.

Promulgated:
DEC 05 2000

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DECISION

This is a judicial claim for refund in the amount of ₱3,146,515.00 representing income taxes which allegedly have been erroneously paid for the taxable year 1996.

Petitioner corporation is a financing company, duly registered and existing under and by virtue of Philippine laws, with principal office address at the 12th floor, 6750 Ayala Avenue, Makati City. It was formerly known as Chailease PBCom Finance Corporation until the amendment of its Articles of Incorporation changing its name on February 14, 1996 to the present one **(Exhibit "A")**. It is engaged in the business of extending credit facilities to commercial or industrial enterprises through discounting or factoring of commercial papers or evidences of indebtedness, or through direct loans with security **(Memorandum for the Petitioner, p. 1)**

The case at bar stems from alleged excess quarterly tax credits/payments accumulated by the Petitioner as against the total tax due contained in its 1996 corporate annual income tax return ("ITR" for short), to wit:

Quarterly Payments in 1996:

	Date of Filing	Amount Paid
1st Quarter	May 30, 1996	P1,691,255.03
2nd Quarter	August 15, 1996	2,196,045.70
3rd Quarter	November 26, 1996	527,601.49
Total tax payments		4,414,902.22
Less:		
Tax due per 1996 ITR		(1,268,387.00)
Overpaid amount/tax refund		P3,146,515.22

Petitioner initially filed a written claim for refund of the aforesaid amount of overpaid tax at the revenue district office in Makati on September 15, 1998 **(Exhibit "G")**. Later on, it filed the same claim before the office of herein Respondent on October 29, 1998 for favorable action **(Exhibit "H")**. However, due allegedly to the continued inaction of Respondent on the claim for refund, it was constrained to file the instant appeal on December 22, 1998 in order to avoid the two-year peremptory period for claiming a refund as provided under Section 230 (now, Section 229) of the Tax Code.

During the pre-trial conference, both parties stipulated on the correctness and validity of all the entries in Petitioner's 1996 ITR, except for the litigation/assets acquired expense in the amount of ₱1,502,196.00 contained under Section D thereof, on deductions from gross income. Likewise, they agreed to the fact that the reduction of the taxable income for 1996 of the Petitioner is primarily attributable to the write-off of the accounts receivable pertaining to Fil-Pack Factors Corporation in the amount of 4,984,780.00 **(Joint Stipulation of Facts; pp.42-44, docket)**.

Consequently, only two issues were raised by the parties, namely:

> 1. Whether or not Petitioner's write-off of accounts receivables pertaining to Fil-Pack Factors Corporation as bad debts, which was approved in 1997 and given retroactive effect in taxable year 1996, is valid; and
>
> 2. Whether or not litigation expenses incurred in the acquisition of assets, through mortgage foreclosures, for taxable year 1996 should be capitalized or treated as outright expense deductible from gross income.

In its memorandum, Petitioner summarized its position based on the evidence it had introduced regarding the treatment of the accounts receivable of Fil-Pack Factors Corporation as a bad debt account citing as authority a ruling of the Supreme Court in the case of **Philippine Refining Company vs. Court of Appeals, 256 SCRA 667**, thus: (1) that there is a valid and subsisting debt; (2) that the debt must be actually ascertained to be worthless and uncollectible during the taxable year; (3) that the debt must be charged off during the taxable year; and (4) that the debt must arise from the business or trade of the taxpayer. [We quote the position of the Petitioner in this regard]:

> 1. the Fil-Pack Factors account is a valid and subsisting debt in the form of a check re-discounting **(TSN dated May 24, 1999, pp. 13-16)**;
>
> 2. the sending of demand letters by Petitioner's external legal counsel, and the institution of criminal cases against no less than the President and lone check signatory of Fil-Pack Factors coupled with Petitioner's own independent efforts and activities to locate the accused and or establish contact with her, and the subsequent disappearance of the accused leading to the archiving of the criminal cases, thus showing a determined but futile effort to collect the debt in good faith; **(Ibid., pp. 16-20; Exhibits "I", "J", "K", "L", & "M")**
>
> 3. the facts and circumstances showing that the debt was ascertained to be uncollectible were known to and duly acknowledged by Petitioner in taxable year 1996 which led Petitioner to commence approval process for the official write-off of the account which approval process was completed in 1997 but prior to the preparation of the 1996 Audited financial statements which was the basis for the 1996 Annual Corporate Income Tax Return; **(TSN, dated May 24, 1999, pp. 20-23; Exhibit "P", inclusive; citing the case of Collector of Internal Revenue vs. Goodrich Internal Rubber Co., 21 SCRA, 1336)**
>
> 4. said debt was written off and charged off in taxable year 1996; **(Ibid., pp. 26-28; Exhibit "O")**
>
> 5. the debt arose from the ordinary course of business of Petitioner, being a financing company authorized to engage in such financing activities like discounting or factoring of commercial papers. **(Exhibit "A"; Citing the case of Philippine Refining Company vs. Court of Appeals, 256 SCRA 667, supra)**

(Memorandum of the Petitioner; p. 154, docket; all citations and notations supplied)

Petitioner explained further that it did ascertain the debt of Fil-Pack Factors Corporation to be uncollectible and worthless in taxable year 1996; that although the approval process for the write-off of the debt was completed in 1997, it was still prior to the closing of all books and the preparation of its audited financial statements for 1996; that, in accordance with generally accepted accounting principles, the latter activities, after considering all possible adjustments of accounting entries, is a practice that is usually accomplished within the first quarter of the following year and filed on or before April 15 of that year.

With respect to the litigation expenses incurred in the acquisition of assets through foreclosure of properties mortgaged to it, Petitioner stressed that it had met the criteria on the deductibility of business expenses as set forth by the Supreme Court in the cases of **Atlas Consolidated Mining and Development Corporation vs. Commissioner of Internal Revenue, 102 SCRA 246** and **Gutierrez vs. Collector of Internal Revenue, 14 SCRA 33**, namely: that the litigation expenses must be classified as ordinary and necessary expenses or routinary in the pursuit of one's business.

Applying the foregoing standard to its situation, Petitioner characterized its litigation expenses in the following manner:

> 1. The business of extending credit facilities or direct loans with security is the principal business of Petitioner;
>
> 2. Foreclosure of mortgaged securities is a necessary incident of and form an integral part of the ordinary and necessary business of financing;
>
> 3. The assets foreclosed and consolidated are not intended to be held on to by Petitioner as these are intended to be sold or disposed of;
>
> 4. Foreclosure activities and the subsequent re-sale of the foreclosed and consolidated properties are done in order to minimize or prevent losses brought about by defaulting client-borrowers.

(Memorandum of the Petitioner; p. 159, docket)

On his part, Respondent posited in his memorandum that Petitioner failed to show compliance on the requisites of deductibility for its bad debts, which in accordance with Section 29(e)(1) of the Tax Code (1993) and Section 102 of Revenue Regulations No. 2, dated February 10, 1940, must encompass the following:

> 1) There must be an existing indebtedness;
>
> 2) The debt must be ascertained to be worthless. The ascertainment of worthlessness requires two (2) facts, to wit:
>
> (i) that the taxpayer did in fact ascertain the debt to be worthless, in the year for which the deduction is sought; and
>
> (ii) that in so doing, he acted in good faith (i.e., he must have investigated the relevant facts and had drawn a reasonable inference from the information obtained by him). In this connection, the taxpayer must perform the following safeguards before the claimed bad debt expense can be deducted: (1) send statements of accounts; (2) send collection letters; (3) give the accounts to a lawyer for collection, and (4) file a collection case in court;
>
> 3) It must be actually charged off within the taxable year; and
>
> 4) The debt must be connected with one's profession, trade or business.
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> (Citing BPI Securities Corporation vs. Commissioner of Internal Revenue, C.T.A. Case No. 4954, dated October 25, 1995, CIR vs. Goodrich International Rubber Co., L-22265, December 22, 1967, 21 SCRA 1336, and Philippine Refining Company vs. CIR, C.T.A. Case No. 4408, February 3, 1993 and A. Soriano Corporation vs. Commissioner of Internal Revenue, C.T.A. Case No. 4803, dated July 1, 1997).

[Memorandum of the Respondent; pp. 164-165, docket]

Firstly, Respondent reasoned that Petitioner was unable to prove the existence of a *valid* debt because while it mentioned two promissory notes, both dated July 11, 1994 in its three demand letters to Fil-Pack Factors Corporation **(Exhibits "I", "J" & "K")** and

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likewise two loan contracts with nos. 94D0071 and 94D00871 executed by the latter totalling ₱4,984,780.00 **(Exhibits "N" & "N-1-a")** as bases for the alleged unpaid debt, nevertheless it failed to present such documents at bar.

Secondly, Respondent contended that there was a failure on the part of the Petitioner to show proof on the worthlessness of the alleged debt of Fil-Pack Factors Corporation because it did not exert earnest efforts to collect the debt of said corporation in the full amount of ₱5,000,000.00. This glaring fact, can be discerned from the non-filing of a civil action by the Petitioner for the collection of the total sum due and the fact that it only filed a criminal complaint based on two bouncing checks worth ₱734,726.00, an amount which, if ever collected, is insufficient to represent an effort in effecting the collection of the full amount of the debt.

Thirdly, it is averred by the Respondent that there is no documentary evidence proving the cancellation and writing off of the bad debt in Petitioner's books of account for taxable year 1996. Respondent pointed out that, as can be read from the memorandum recommended by Mr. Wen Cheng, Executive Vice-President for Management Committee's Approval **(Exhibits "P" to "P-2")**, clearly indicate that said write off was not reflected in Petitioner's financial statements as of December 31, 1996.

Lastly, Respondent also took issue on the date at which the bad debt was duly ascertained to be worthless. He asseverated that the approval and ratification of the writing off of the obligation as a bad debt by the Board of Directors of Petitioner was done in 1997, hence, its deduction as an expense item should apply only for the same year and not in 1996.

On the issue of deductibility of litigation expenses, Respondent believed that the cost of defending or perfecting title to property should be capitalized, citing Section 120 of Revenue Regulations No. 2 and the case of **Atlas Consolidated Mining and Development Corporation vs. Commissioner of Internal Revenue, 102 SCRA 246.** This view is particularly compelling on account of the fact that Petitioner is engaged in the business of buying and selling real and personal properties as can be gleaned from its Articles of Incorporation **(Exhibit "A")**.

After a careful examination of the attending facts and issues, the arguments of the parties, and the laws and jurisprudence in point, this Court hereby rule in favor of the Respondent.

Skirting the disquisitions of the parties on the issues involved, this Court notes that the 1996 income tax return shows that Petitioner carried over to 1997 the refundable amount of P3,146,515.00. However, the 1997 ITR of the Petitioner **(Exhibit "F")** shows under Box 6 of Section B thereof an "x" mark on the number 2 box, which reveals the intention of the Petitioner to elect and apply as automatic tax credit to next year (1998) its total amount of creditable taxes unutilized for the year 1997. It chose not to tick off the number 1 box pertaining to refund of excess tax credits. In addition, this Court further observe that the 1998 ITR of the Petitioner had not been adduced in evidence thus making it impossible for the Court to verify the status of the tax credits carried over from 1997 to 1998, whether they have been used up or remained available.

In this regard, herein claim for refund is doomed from the very start. In the decision of the Honorable Court of Appeals in **Pasco Realty and Development Corp. vs. Commissioner of Internal Revenue, CA G.R. SP No. 33589, October 14, 1994**, it was held that an application for automatic tax credit to the succeeding taxable year of excess credits, as allowed by Section 7 of Revenue Regulations No. 10-77 of the Bureau of Internal Revenue, will no longer entitle the Petitioner to a refund *because to do so would be tantamount to granting twice the refund being sought*, thus:

> In the instant case, it appears that when Petitioner filed its income tax return for the year 1989, it filled up the box stating that the total amount of P172,447.00 shall be applied against its income tax liabilities for the succeeding taxable year.
>
> Petitioner did not specify in its return the amount to be refunded and the amount to be applied as tax credit to the succeeding taxable year, but merely marked an "x" to the box indicating "to be applied as tax credit

> to the succeeding taxable year." Unlike what Petitioner had done when it filed its income tax return for the year 1988, it specifically stated that out of the P146,026.00 the entire refundable amount, only P64,623.00 will be made available as tax credit, while the amount of P81,403.00 will be refunded.
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> In its 1989 income tax return, Petitioner filled up the box " "to be applied as tax credit to succeeding taxable year", which signified that instead of a refund, Petitioner will apply the total amount of P172,447.00, which includes the amount of P54,140.00 sought to be refunded, as tax credit for its tax liabilities in 1990. Thus, there is really nothing left to be refunded to Petitioner for the year 1989. To grant Petitioner's claim for refund is tantamount to granting twice the refund herein sought to be refunded, to the prejudice of the Government.

Likewise, in the case of **BPI data Systems Corporation (formerly Filipinas Management and Leasing Services, Inc.) vs. Commissioner of Internal Revenue, CTA Case No. 4691, promulgated on December 6, 1993 (affirmed by the Supreme Court in G.R. No. L -- 127021 ; Entry of Judgment, dated April 4, 1998)**, this Court had the occasion to dwell on the merits of a failure to submit in evidence the ITR for the succeeding year for the purposes of showing that the amount being claimed for refund in the immediately preceding year has indeed been appropriately ticked off or marked under the box properly designated for refund of excess tax credits. This Court held:

> On December 20, 1991, Petitioner filed a claim for refund with respondent's Legislative Ruling and Research Division asking for the refund of the remaining ₱199,255.60, representing alleged excess creditable withholding tax for 1989. Without waiting for Respondent's decision, Petitioner filed on December 27, 1991, a Petition for Review before this Court.
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> After a thorough review of the arguments raised by both parties this Court arrived with the following findings. In the process of going over the records of the case, the Court noted that the 1990 Income Tax Return was not presented in evidence by the Petitioner. Had it been presented in evidence, Petitioner may have claimed as tax credit the amount sought for. Accordingly, since the 1990 Income Tax Return was not presented, it cannot be ascertained whether the refundable amount of ₱199,255.60 was already credited being part of ₱877,857.60 applied for as

tax credit to the succeeding taxable year 1991. There is no way by which this Court can determine how much it is legally entitled to.

In fine, since it appears that herein Petitioner has already been granted an automatic credit on its overpaid income tax to be applied to succeeding years (1997 and 1998); and that its 1998 ITR has not been proffered in evidence to demonstrate, if ever, that such amount carried over as tax credit had been eventually elected for refund in 1998, it follows then, that there is really nothing more to be refunded in the case at bar.

It must be stressed at this point that a refund (or tax credit) of the taxes partakes the nature of a tax exemption and is construed in *strictissimi juris* against the taxpayer and in favor of the taxing authority **(Associated Sugar, Inc. vs. CIR, CTA Case No. 2944, May 6, 1994, p. 4, citing Insular Lumber Co. vs. CTA, 109 SCRA 721)**.

With this Court's finding, it can be seen that the issues presented by the parties are deemed moot and academic already as they no longer have any bearing on the outcome of the case at bar.

However, for purposes of elucidation, this Court would like to dwell, *ex gratia argumenti*, on the merits of the bad debt claimed by the Petitioner and disputed by the Respondent.

This Court is convinced that Petitioner is not entitled to a bad debt deduction simply because it did not exert effort to file a collection case before the courts **(BPI Securities Corporation vs. Commissioner of Internal Revenue, CTA Case No. 4954, October 25, 1995 and Philippine Refining Company vs. Commissioner of Internal Revenue, CTA Case No. 4408, February 3, 1993)**. As correctly observed by the Respondent, what Petitioner did was merely to file a criminal complaint for violation of the bouncing check law (B.P. Blg. 22) which, if ever it wins the case and assuming further that the civil aspect of the case has not been reserved, would only entitle it to the lesser amount of ₱734,726.00, corresponding to the amount of the checks that bounced.

The amount claimed by the Petitioner as bad debt totaled ₱4,984,780.00 yet, no civil action for its collection was ever initiated before the courts.

In addition, it can be observed that Petitioner was unable to prove by primary evidence the alleged existence of debt by Fil-Pack Factors Corporation, in violation of the Best Evidence Rule found under Section 3 of Rule 130 of the Rules of Court. The documentary proofs submitted by the Petitioner are, at best, circumstantial (Exhibits "I" to "R"). This Court wonders why the alleged promissory notes or loan contract directly exhibiting the indebtedness were not presented. It is a requirement that in the availment of bad debt, the existence of a valid debt be duly established **(BPI Securities Corporation and Philippine Refining Company cases, supra)**. In this regard, the presentation of the original documents is imperative; their contents would explicitly reveal the true existence of an actual and valid debt.

WHEREFORE, in view of the foregoing, the instant Petition for Review is hereby **DISMISSED** for lack of merit.

SO ORDERED.

RAMON O. DE VEYRA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

AMANCIO Q. SAGA
Associate Judge

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CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Judge