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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

March 20, 1963

PLARIDEL SURETY & INSURANCE COMPANY,
Petitioner,

versus

CTA CASE NO. 1037

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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DECISION

This is an appeal from the decision of respondent Commissioner of Internal Revenue disallowing the sum of ₱44,490.00 claimed by petitioner Plaridel Surety & Insurance Co., as a deductible loss from its gross income for the year 1957, and assessing against and demanding from said petitioner the amount of ₱8,898.00 as deficiency income tax for said year 1957, plus interest (Par. 11, Petition for Review; Par. 1, Answer; Exh. N, p. 77, CTA rec.; Exh. 6, p. 67, BIR rec.).

The petitioner is a domestic corporation engaged in the bonding business. It appears that on November 7, 1950, P. L. Galang Machinery Co., Inc. entered into an agreement with Constancio San Jose in which the former agreed to buy logs for export from the latter who obligated himself to produce and supply said logs. (Exh. A, pp. 24-26, CTA rec.) To secure the full and faithful performance of his part in said contract, Constancio San Jose, as principal, and the petitioner, as surety, executed a performance bond in favor of P. L. Galang Machinery Co., Inc. in the penal sum of ₱30,600.00 (Exh. B, pp. 27-28, CTA rec.).

The petitioner, in order to afford itself adequate protection against loss or damage on the performance bond, required Constancio San Jose and one Ramon F. Cuervo to execute an indemnity agreement obligating themselves, jointly and severally, to indemnify the petitioner for whatever liability the latter may incur by reason of the bond. As security, Constancio San Jose executed a chattel mortgage of logging machineries and other personal properties in favor of the petitioner (Exh. K, pp. 71-73, CTA rec.) while Ramon F. Cuervo executed a real estate mortgage also in favor of the petitioner (Exh. L, pp. 74-76, CTA rec.).

When Constancio San Jose failed to deliver the logs to P. L. Galang Machinery Co., Inc. in accordance with the terms of their agreement, the performance bond issued by the petitioner was declared forfeited in favor of P. L. Galang Machinery Co., Inc. in a decision promulgated by the Court of First Instance of Manila (Exh. C, pp. 29-43, CTA rec.) which was affirmed by the Court of Appeals on June 17, 1955 (Exhs. D and D-1, pp. 44-49, CTA rec.) and by the Supreme Court on January 11, 1957 (Exhs. E and E-1, pp. 50-57, CTA rec.). Pursuant to said decision, the petitioner paid to P. L. Galang Machinery Co., Inc., the total amount of ₱44,490.00 in 1957 (Exhs. F, F-1 to F-6, pp. 58-64, CTA rec.).

For the taxable year 1957, the petitioner filed its income tax return claiming therein as a deductible loss from its gross income the sum of ₱44,490.00, and paid as per said return the amount of ₱136.00 as income tax for the year 1957 (Exhs. J & J-1, pp. 68-69, CTA rec.). However, the respondent disallowed said deduction of ₱44,490.00 and assessed against the petitioner the sum of ₱8,898.00, plus interest, as deficiency income tax for the year 1957 (Exhs. G, H & I, pp. 65-67, CTA rec.). The petitioner protested against and requested for the reconsideration of the deficiency assessment but the respondent, in a letter dated March 1, 1961, dismissed the protest and denied the request for reconsideration (Exh. N, p. 77, CTA rec.). Hence, the present appeal.

As correctly stated by both the petitioner and the respondent, the only issue in this case is whether or not the sum of ₱44,490.00 paid by the petitioner to P. L. Galang Machinery Co., Inc. in 1957, pursuant to a final judgment on a performance bond executed by the petitioner in favor of P. L. Galang Machinery Co., Inc., is a deductible loss under Section 30(d) (2) of the National Internal Revenue Code, for the purpose of computing the net income of the petitioner for the same year.

Section 30(d) (2) of the National Internal Revenue Code provides as follows:

> "Sec. 30. Deductions from gross income. - In computing net income there shall be allowed as deductions -
>
> x x x x x
>
> "(d) Losses:
>
> x x x x x
>
> "(1) By corporations. - In the case of a corporation, all losses actually sustained and charged off within the taxable year and not compensated for by insurance or otherwise." (Underscoring supplied)

Note that one of the requisites before a loss or damage can be considered and allowed as a deduction from the gross income in computing the net income is that said loss or damage is "not compensated for by insurance or otherwise". As interpreted and applied by the Supreme Court, the vocable "otherwise" in the clause "compensated for by insurance or otherwise" should be construed to refer to compensation due under a title, analogous or similar to insurance. Inasmuch as the latter is a contract establishing a legal obligation, it follows that in order to be deemed "compensated for . . . otherwise", the loss sustained by a taxpayer must be covered by a judicially enforceable right, springing from any of the juridical sources of obligations, namely: law, contract, quasi-contract, torts or crime (Cu Unjieng Sons, Inc. vs. Board of Tax Appeals, G. R. No. L-6296, Sept. 29, 1956).

In the case at bar, the loss sustained by the petitioner was "compensated for (by insurance or) otherwise", and therefore, it has not in fact and in law suffered any loss and no deduction should be allowed. More particularly, the alleged deductible loss was covered by a judicially enforceable right based on a contract - an indemnity agreement signed by Constancio San Jose and Ramon F. Cuervo in favor of the petitioner. As a matter of fact, the petitioner has already secured a favorable judgment against Constancio San Jose and Ramon F. Cuervo which is now final and executory.

It is true that there is no reasonable ground to expect reimbursement from Constancio San Jose for the amount paid to P. L. Galang Machinery Co., Inc. However, petitioner Plaridel Surety & Insurance Co., Inc. must exhaust its remedies to recover or at least to reduce its loss by going after the properties of Ramon F. Cuervo, a real estate man. When reminded by this Court during the hearing of its right to compensation against Ramon F. Cuervo, witness Hermogenes R. Dimaguiba, President of petitioner Plaridel Surety & Insurance Co., Inc., said:

> "We have not gone to that extent of exhausting all the remedies, on all the properties of Mr. Cuervo because we are after first Mr. Constancio San Jose because, according to Mr. Cuervo it was Mr. San Jose who benefited from this transaction and he was just the guarantor. He just guaranteed for Mr. San Jose, . . ." (p. 50, t.s.n.).

And when this Court pointed to the petitioner that it should go after Mr. Cuervo because he assumed a joint and several obligation with Mr. San Jose, witness Dimaguiba answered: "We will do that, Your Honor" (p. 51, t.s.n.). The fact that the petitioner has failed up to the present to recover any amount even if only to reduce its loss from Ramon F. Cuervo due to business or personal motives, or because of ignorance of the law, is a cause for the denial of the right to the deduction (Mertens, Law of Federal Income Taxation, Vol. 5, Chapter 28, p. 19).

WHEREFORE, in view of the foregoing considerations, petitioner Plaridel Surety & Insurance Co. Inc. is hereby ordered to pay the respondent Commissioner of Internal Revenue the amount of

₱8,898.00 as deficiency income tax for the year 1957, within thirty (30) days from the date this decision becomes final.

If any amount of the tax is not paid within the time prescribed above, there shall be collected a surcharge of 5% of the tax unpaid, plus interest at the rate of 1% a month from the date of delinquency to the date of payment, provided that the maximum amount that may be collected as interest shall not exceed the amount corresponding to a period of three (3) years. With costs against the petitioner.

SO ORDERED.

Manila, Philippines, March 20, 1963.

AUGUSTO M. LUCIANO
Associate Judge

WE CONCUR:

MARIANO NABLE
Presiding Judge

ROMAN M. UMALI
Associate Judge