Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

CHINA BANKING CORPORATION,
Petitioner,

- versus -

C.T.A. CASE NO. 4504

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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8/13/93

D E C I S I O N

Petitioner is a corporation duly organized and existing under the laws of the Philippines and authorized to engage in the general banking business.

Petitioner owns 106,000 shares of stock in a Hongkong subsidiary known as the First CBC Capital (Asia), Limited, amounting to P16,227,851.80, or approximately fifty-three percent (53%) of the total equity of the company.

For the year ended in 1987, petitioner wrote-off as worthless securities its entire equity investment in First CBC Capital (Asia), Limited, consisting of the said 106,000 shares of stock amounting to P16,227,851.80, treating the same as a bad debt expense and consequently, considered it as an ordinary loss deduction from gross income in its 1987 income tax return.

Respondent, on January 25, 1990, issued a letter of demand under Assessment No. FAS 1-5-87-90-000 against petitioner for, among other things, 1987 deficiency tax plus surcharge, interest and compromise penalty, in the total amount of P8,533,328.04 resulting from the disallowance of the bad debt expense - the write-off of alleged worthless securities in First CBC Capital (Asia), Limited.

Petitioner, in a letter, dated May 7, 1990, formally protesting said assessment stated in effect that:

a. The total worthlessness of petitioner's shares of stock in First CBC Capital (Asia), Limited, was established beyond all doubt due to severe financial reverses and that said company ceased its business operations and even surrendered its license to operate.

b. The write-off of worthless securities was correctly treated by petitioner as a bad debt expense for which an "ordinary loss" deduction from gross income was correctly taken under pertinent provisions of the Tax Code, more particularly Sec. 3 (e), now Sec. 29 (e) (2) thereof.

Respondent, in a letter, dated August 22, 1990, rendered its final decision on petitioner's protest, denying the same and reiterating its demand for payment of the latter's 1987 deficiency income tax, plus surcharge, interest and compromise penalty, in the total amount of P8,533,328.04.

Hence, this Petition for Review.

Petitioner anchors its corporate decision to the write-off of its entire investment with First CBC Capital (Asia), Limited, as worthless securities on the ground that said off-shore company was bankrupt and that its investment in the form of securities no longer had any value at all (July 4, 1991, t.s.n., pp 7-8). Petitioner further avers that this corporate decision was shared by the Hongkong authorities, more particularly, the office of the Commissioner of Banking. The external auditors of the First CBC Capital (Asia), Limited which is Berne and Co., the internal auditors of petitioner, Sycip, Gorres and Velayo and Co. and the Central Bank of the Philippines, were also of the same "opinion." A witness for the petitioner, Mr. Zacarias Antonio, Head of the Central Accounting Department, testified that examiners of the Central Bank made the conclusion that the First CBC Capital (Asia), Limited, "is already an insolvent company and that in their report of examination, petitioner was required to 'book an allowance', a one hundred percent (100%)

allowance, considering that the investment is already lost." Petitioner further drew the conclusion that the equity investment account is qualified to be written-off, which decision was approved by the Board of Directors with the final approval of the Central Bank of the Philippines. As stated earlier, petitioner considered these so-called worthless securities as a bad debt expense and consequently as an ordinary loss deduction from gross income in its income tax return for the year ended in 1987.

Respondent in his Answer averred that in the present case, there is no loan or debt to speak of as understood under Section 30 (e) (2), now Section 29 (e) (2), of the Tax Code. Accordingly, no bad debt expense could arise where there is no valid or subsisting debt. He further stated that the revocation of the registration of First CBC (Asia), Limited in 1987 was only for its deposit-taking activities while its (company's) financing and investment holding concerns remained; therefore, the alleged debt or investment could not be considered worthless and deductible in 1987.

In the First CBC Capital (Asia) Limited Report and Financial Statements for the year ended 31 December 1987 prepared by Berne and Co. (Exh. E), it confirmed that the "principal activities of the company during the year were in financing and investment holding." It disclosed however that the company was "de-registered" as a deposit-taking company during the year. Based on the audited financial statements as reported by its external auditors to the shareholders of First CBC Capital (Asia), Limited, the company had collectible amounts due from the subsidiary of HK $4,159,595.00 included under interest in subsidiary, as well as loans extended to customers and other debtors totalling HK $46,264,929.00 although the auditors were unable to obtain independent confirmations of these balances. There was even an investment of HK $38,892.00 in the subsidiary.

It would appear therefore that based on the audited financial statements for the year ended 31 December 1987, the First CBC Capital (Asia) Limited was a going concern, operating probably under difficult circumstances, but certainly, with no indication that it was going bankrupt. No evidence was introduced indicating that this company had applied for bankruptcy nor a declaration of bankruptcy under the banking laws and regulations of Hongkong where it is based. There was likewise no evidence presented that the company continued to exist, that is as of 1987, for purposes of liquidation. What is clear on the record is that the company was de-registered as a deposit-taking company, one of its business activities, during the year in question. However, its principal activities as a financing and investment holding company continued as shown by its exposure and business operations in the form of loans to customers and other debtors and investments.

Petitioner is an investor of the entire First CBC Capital (Asia), Limited, not just a segment or portion of its operation or business. The declaration by the petitioner of the "worthlessness" of its shares of stock was a company decision. The reason for its decision could be gleaned from the testimony of Mr. Ricardo R. Chua, Head of the Operations and Control Division of petitioner, when he stated that:

> "....the only way they will allow us to continue operation, is to infuse additional capital but then there were several things in our mind. We felt that continuing its operation, somehow is not going to guarantee that we can recover. In fact, we felt 99% that is going to result into a loss. Considering the overhead cost involved in Hongkong, plus the fact that, the country just went through foreign exchange crisis two years before that, and we felt that the country needed the foreign exchange more here, than to throw it to Hongkong. So we then decided. It was very painful decision for us. We said 'let go Hongkong.' We have to close operation, because we are told, 'if you do not infuse any capital

then we will close you down.'" [July 4, 1991, T.S.N., pp. 9-10]

Petitioner also lay stress on the findings of the Central Bank that the First CBC Capital (Asia), Limited is insolvent and the Central Bank of the Philippines has approved the write-off. To our mind, such determination is ill-conceived. It is not for the Central Bank of the Philippines to determine the solvency or insolvency of the First CBC Capital (Asia), Limited. Its recommendation to write-off the investment and provide reserve is not in any way synonymous to insolvency of the company much less worthlessness of the securities in question.

We cannot therefore agree with the proposition of petitioner that its investment was entirely worthless. There were other options open to it which it decided not to pursue. Instead, petitioner chose to "let go" its investment in Hongkong by declaring them "worthless" and to salvage a bad situation, avail of the provision of the Tax Code by considering said investment as a bad debt expense so that its investment will not be entirely lost. But as borne by the evidence, its Hongkong connection continued to be a going concern, with some problems admittedly, but still viable.

Under the circumstances, petitioner cannot rely on Section 29 (e) (2) of the NIRC to escape assessment. The law provides thus:

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> (e) Bad Debts. - (1) In general. - Debts due to the taxpayer actually ascertained to be worthless and charged off within the taxable year except those not connected with profession, trade or business and those sustained in a transaction entered into between parties mentioned under Section 30 (b) of this Code.
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> (2) Securities becoming worthless. - If securities as defined in Section 20 are ascertained to be worthless and charged off within the taxable year and are capital assets, the loss resulting therefrom shall, in the case of a taxpayer other than a bank or trust company incorporated under the laws of the Philippines a substantial part of whose business is the receipt of deposits, for the purpose of this Title, be considered as a loss from the sale or exchange, on the last day of such taxable year of capital assets. (underscoring supplied)

Requisites for deductibility of bad debts are: (1) the debt must be ascertained to be worthless as when the debtor is insolvent; (2) it must be actually charged-off within the taxable year; and (3) the debt must be connected with one's profession, trade or business. In determining whether a debt is worthless, the Commissioner of Internal Revenue will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial conditions of the debtor (Sec. 102, Rev. Regs. No. 2).

Having determined that the investment of petitioner was not entirely worthless, it cannot translate the same as a bad debt expense under the above provision of law. There is actually no debt to speak of much less a bad debt expense under the law and existing administrative regulations. Likewise, petitioner's citation of the case of Fernandez Hermanos, Inc. vs Commissioner of Internal Revenue, 29 SCRA 552, to the effect that worthless securities owned by a corporation in another corporation could be written-off as an ordinary loss deductible under the Tax Code, is not applicable to the case at bar, because petitioner is differently circumstanced. It should be recalled that the company in said case, ceased to operate when the owner died, it had no assets and was completely insolvent. *In fine*, petitioner has not successfully impugned the validity of the assessment of respondent Commissioner of Internal Revenue and therefore all presumptions are in favor of the correctness of the latter's assessment against the petitioner.

WHEREFORE, the decision of the respondent Commissioner of Internal Revenue is therefore affirmed and petitioner is hereby ordered to pay respondent the amount of P8,533,328.04 as deficiency income tax for the year 1987, plus twenty percent (20 %) interest per annum until fully paid, with costs against the petitioner.

SO ORDERED.

Quezon City, Metro Manila, August 13, 1993.

RAMON O. DE VEYRA
Associate Judge

WE CONCUR:

(dissenting)
ERNESTO D. ACOSTA
Presiding Judge

MANUEL K. GRUBA
Associate Judge

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