Lit

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

A. SORIANO CORPORATION,
Petitioner

- versus - C.T.A. CASE NO. 2951

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

3/30/82

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

D E C I S I O N

This suit brought by petitioner A. Soriano Corporation for tax credit of the amount of ₱415,075.19 as overpaid income tax for the year 1974 poses the question of whether or not respondent Commissioner of Internal Revenue was justified in his refusal to permit deduction from the gross income of petitioner of an alleged indebtedness ascertained to be worthless and charged off in the said taxable year.

As shown by the pleadings submitted by the parties and records of the case, it appears that petitioner is a domestic corporation engaged in business primarily as general managers of certain corporations. It is authorized to invest in other businesses and to own property.

On April 15, 1975, petitioner filed its income tax return for taxable year 1974 declaring therein a net taxable income of ₱20,580,121.46. (Exh. "1", pp. 60-69, BIR records.) Upon investigation of said return by respondent's examiners, the disallowance, among other items, of bad debts deduction in the amount of ₱1,039,239.85 was recommended. (Exhs. "2", "2-A", pp. 79-81, BIR records.) As a consequence thereof, respondent assessed and demanded from petitioner, in a letter dated April 19, 1976, the payment of the amount of ₱540,007.35 as deficiency income tax for 1974, the details of which are as follows:

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Net income per return - - - - - - - - - -		₱20,580,121.46
Add: Unallowable deductions:		
(1) Administrative Expenses - not supported - -	197,347.46	
(2) Bonus - 1972 expense -	65,000.00	
(3) General Expenses - personal and/or not supported -	50,448.58	
(4) Bad debts - still collectible	1,039,239.85	1,352,035.89
Net income per investigation - - - - -		₱21,932,157.35
Tax due thereon - - - - - - - - - -		₱ 7,666,255.00
Less: Amount already assessed - - - -		7,193,042.00
B a l a n c e - - - - - - - - - -		₱ 473,213.00
Add: 14% int. fr. 4-16-75 to 4-19-76 -		66,794.35
TOTAL AMOUNT DUE & COLLECTIBLE		₱ 540,007.35

(Exh. "3", pp. 93-94, BIR records.)

On April 27, 1978, petitioner filed with respondent a claim for tax credit, asserting that the disallowance of bad debts deduction finds no legal basis in the Tax Code; and considering that it had paid the income tax plus interest on the disallowed amount of ₱1,039,239.85, it is entitled to a tax credit in the sum of ₱415,075.19, computed thus:

Bad debts written off but disallowed		₱1,039,239.85
35% tax thereon	₱363,733.93	
14% interest, 4/16/75 to 4/19/76	51,341.26	
Total tax credit	₱415,075.19	

(Exh."5", pp. 99-100, BIR records.)

It appears that petitioner had paid the amount of ₱540,007.35 as deficiency income tax on May 19, 1976. (See Memorandum for the Chief, Appellate Division, p. 100, BIR records.)

Since no action was seasonably taken by respondent on the aforesaid claim for tax credit, petitioner appealed to this Court on May 4, 1978.

Is petitioner legally entitled to a tax credit in the amount of ₱415,075.19?

A determination of how petitioner's claim for bad debts deduction arose would be helpful in the resolution of the issue presented in the case at bar.

The records disclose that petitioner owned in 1974 and earlier a nickel mining concession in Palawan, covered by some 12,000 to 13,000 hectares surface area of timber stand. The timber stand, however, belonged to a logging concessionaire, the Victoria Range Forest Resources, Inc., hereinafter called VRFR for short. VRFR has a small sawmill in the area of its forest concession, and sold its logs and timber products locally. (See pp. 3-5, t.s.n., hearing of June 19, 1979.)

To enable it to conduct its operations, VRFR bought some of its machinery and equipment and leased a greater part thereof from the Makati Leasing Corporation under terms and conditions set forth in a lease agreement entered into with the latter. (pp. 6-8, t.s.n.; Exh. "B".) On its part, petitioner executed an Undertaking And Guaranty in favor of the Makati Leasing Corporation whereby it agreed to guarantee performance by VRFR of all the obligations called for in the lease agreement. Petitioner's undertaking as set forth in the document is as follows:

> "1. WHEREAS, the MAKATI LEASING CORPORATION, a corporation organized and existing under the laws of the Philippines, with postal address at the 6th Floor, Insular Life Building, Ayala Avenue, Makati, Rizal, has executed a contract of lease dated May 21, 1971, with VICTORIA RANGE FOREST RESOURCES, INC., a copy of which is hereto attached and made a part hereof as Annex 'A';

"2. WHEREAS, the aforesaid VICTORIA RANGE FOREST RESOURCES, INC. as lessee, and the MAKATI LEASING CORPORATION would not have executed the contract of lease of equipment specified in the Schedule attached to Annex 'A' without the solidary guarantee of A. SORIANO Y CIA., and the latter has agreed to guarantee performance by the lessee of all its obligations to the lessor under the said contract.

"NOW, THEREFORE, for and in consideration of the premises, A. SORIANO Y CIA., hereby:

(a) Guarantee unto the MAKATI LEASING CORPORATION the prompt and full performance by the lessee VICTORIA RANGE FOREST RESOURCES, INC. of all its obligations, including the payment of the rents and other amounts due or which shall hereafter become due, to the said corporation under the aforesaid contract of lease;and

(b) Undertakes to remit to the said MAKATI LEASING CORPORATION at its aforesaid postal address all the rents and other obligations including insurance premiums, license and registration fees and other charges under the contract of lease.

"It is understood that the above guaranty is effective and enforceable independently of the existence or non-existence of funds pertaining to VICTORIA RANGE FOREST RESOURCES, INC. and in the possession of A. SORIANO Y CIA."

(Exh. "A")

As VRFR lagged behind in its scheduled payments of rentals, the Makati Leasing Corporation collected directly from petitioner who paid the accounts. (Exhs. "C" to "C-14", "M" to "AA-1")

It appears that all these payments and advances for the account of VRFR exceeded ₱1,051,739.83. (Exhs. "CC" & "DD".)

Petitioner, on several occasions, sent demand letters for payment of the advances made by it to the Makati Leasing Corporation, but VRFR consistently asked for grace period to pay. (Exhs. "D" to "J-3")

In the latter part of 1973 and early part of 1974, VRFR sold its machinery and equipment for ₱605,000.00, which it turned over to petitioner in partial payment of its obligations. (Exhs. "K" & "L"; "CC" & "DD".) Considering petitioner's collection efforts, against the fact that VRFR sold its machinery and equipment and ceased logging operations in 1974, and the bleak picture reflected by the latter's financial statements (Exhs. "I", "I-1" to "I-4"), petitioner ascertained in 1974 that the VRFR debt was worthless and uncollectible and charged off as bad debts in that year the amount of ₱1,051,739.83. (Exh. "BB") Petitioner claimed therefore the sum of ₱1,051,739.83 as bad debts deduction in its 1974 income tax return. Of this amount, respondent refused however to allow deduction of the sum of ₱1,030,230.85, which, as stated earlier, petitioner paid the income tax plus interest due thereon, and from which the present proceedings for allowance of tax credit in the sum of ₱415,075.19 arose.

The applicable provision of Section 30(e)(1) of the National Internal Revenue Code permits the deduction of "debts due to the taxpayer actually ascertained to be worthless and charged off within the taxable year." In order that a bad debt deduction may be validly claimed, it is essential (1) that there be a valid and subsisting debt, and (2) that the debt be actually ascertained to be worthless and charged off within the taxable year. (Philippine Trust Co. vs. Collector of Internal Revenue, CTA Case No. 367, January 30, 1961.)

Petitioner's position in the instant case is that, by virtue of the undertaking and guaranty it executed and its payment of the obligations of VRFR pursuant thereto to the Makati Leasing Corporation, it became a creditor of VRFR. Petitioner should therefore be permitted to deduct the amounts so paid as debts "actually ascertained to be worthless and charged off" in 1974, VRFR having been shown to be incapable of paying its obligations or of reimbursing petitioner of the payments it made. A claim of subrogation is thus made by petitioner.

Contrariwise, respondent maintains that the existence and basis of the indebtedness of VRFR to petitioner has not been proven. Respondent contends that petitioner's payment of the obligations of VRFR did not give rise to a debtor-creditor relationship between them because nowhere in the undertaking and guaranty, nor from the evidence presented, could there be found an unconditional obligation of VRFR to repay, should it be remiss in paying the rents and other obligations arising under the lease agreement with the Makati Leasing Corporation. Hence, the amount so paid by petitioner cannot be considered as worthless debt which could be charged off. Respondent further asserts that the propriety of bad debts deduction was not shown by petitioner.

Although petitioner herein, pursuant to the undertaking and guaranty, was depicted as a guarantor of the obligations of VRFR, its liability was primary; an insurer of the debt not the solvency of the debtor; and required to pay if VRFR did not comply with its obligations without benefit of excussion. Thus:

> "2. WHEREAS, the aforesaid VICTORIA RANGE FOREST RESOURCES, INC. as lessee, and the MAKATI LEASING CORPORATION would not have executed the contract of lease of equipment specified in the Schedule attached to Annex 'A' without the solidary guarantee of A. SORIANO Y CIA., and the latter has agreed to guarantee performance by the lessee of all its obligations to the lessor under the said contract." (Undertaking And Guaranty, supra.; underscoring supplied)

In other words, the Makati Leasing Corporation did not rely solely and exclusively on the ability and capability of VRFR to comply with its commitments but rather on petitioner's representation and undertaking of being solidarily liable thereto in the performance of the obligations called for in the lease contract. Having guaranteed VRFR's obligations in such manner and under such circumstances as to constitute petitioner, in practical effect, the primary obligor thereof, a debt did not spring into existence by payment of the obligations, and the amount paid thereof is not deductible as a debt found to be worthless and charged off within the taxable year in the computation of its net taxable income. (Florence O.R. Lang, et al. vs. Commissioner of Internal Revenue, 32 United States Board of Tax Appeals Report 522.) Truly, we can not find any stipulation of unconditional obligation on the part of VRFR to repay petitioner, because, as stated by petitioner itself, "The business reason for the accommodation was obvious - the logging operations by VRFR would actually clear and clean the surface area covering the nickel concession of petitioner, virtually preparing the ground for its contemplated nickel mining operations at practically no expense to it." (p. 35, CTA records.)

By guaranty a person, called a guarantor, binds himself to the creditor to fulfill the obligation of the principal debtor in case the latter should fail to do so. However, if a person binds himself solidarily with the principal debtor, the provisions of Section 4, Chapter 3, Title I of Book IV of the Civil Code should be observed. In such case the contract is called suretyship. (Art. 2047, Civil Code.) In suretyship the surety becomes liable to the creditor without the benefit of the principal debtor's excussion of his properties, for he (the surety) may be sued independently. So, he is an insurer of the debt and as such he has assumed or undertaken a responsibility or obligation greater or more onerous than that of a guarantor, who is merely the insurer of the solvency of the debtor. A surety is almost the same as a <u>solidary debtor, except that the latter is himself a principal debtor.</u> (Manila Surety and Fidelity Company, Inc. vs. Batu Construction and Company, et al., L-9353 May 21, 1957, 101 Phil. 494.) In a solidary or joint and several obligation, the relationship between the active and the passive subjects is so close that each of the former or of the latter may demand the fulfillment of or must comply with the whole obligation. (8 Manresa 194.) As Justice Edgardo L. Paras of the Court of Appeals succintly stated in his Civil Code of the Philippines Annotated, 9th edition 1978. Volume IV, page 207, "Solidary Obligations - 'One for all, all for one.'"

Being solidarily liable, petitioner can not now claim that it was a mere guarantor. Consequently, when it complied with its obligations under the Undertaking and Guaranty dated May 26, 1971, no debtor-creditor relationship sprang into existence between VRFR and petitioner.

Upon failure therefore to obtain reimbursement thereof, petitioner was not entitled to take a deduction as bad debt under Section 30(c)(1) of the National Internal Revenue Code. (See Shiman vs. Commissioner of Internal Revenue, 60 Federal Reporter, 2d Series, 65.) And as to the claim of subrogation, there is good authority to the effect that one who indemnifies creditor for the non-performance of obligation does not by payment thereof acquire remedy over against debtor, in absence of stipulation therefor. (See Howell vs. Commissioner of Internal Revenue, No. 9674, 69 F.(2d) 447;

Finally, we agree with respondent that petitioner had not attached to its income tax return for 1974 a statement showing the propriety of the deduction therein made for alleged bad debts in violation of Section 102 of Revenue Regulations No. 2. (Collector of Internal Revenue vs. Goodrich International Rubber Co., L-22265, December 22, 1967, 21 SCRA 1336.)

Petitioner A. Soriano Corporation having failed to show that the disallowance of its bad debts deduction by respondent Commissioner of Internal Revenue was erroneous and unjustified, it is not entitled to the tax credit of the amount of ₱415,075.19. The claim thereof should therefore be denied.

WHEREFORE, finding no merit in this appeal, the above-entitled case is hereby dismissed, with costs against petitioner.

SO ORDERED.

Quezon City, March 30, 1982.

AMANTE FILLER
Presiding Judge

WE CONCUR:

CONSTANTE C. ROAQUIN
Associate Judge

ALEX Z. REYES
Associate Judge