REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

BPI SECURITIES CORPORATION,
Petitioner,

- versus -

C.T.A. CASE NO. 4954

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
OCT 25 1995

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D E C I S I O N

This case involves an appeal from the decision of respondent Commissioner of Internal Revenue affirming the disputed assessments of alleged deficiency income and percentage taxes for the year 1987, in the amounts of P302.823.79 and P9,377.73, respectively.

Petitioner is a domestic corporation duly organized and existing under the laws of the Philippines. Petitioner is a subsidiary of the Bank of the Philippine Islands. It is primary engaged in business as a stock broker and dealer in securities.

On March 19, 1991, respondent issued Assessment Notice against petitioner for alleged Deficiency Income, Percentage and Documentary Stamp Taxes for the year 1987 by virtue of the report of investigation conducted on its books under Letter of Authority No. 0017812 NA (Exh. 1, p. 1 BIR record), dated August 22, 1988, regarding its income and business tax liability for the calendar year ending December 31, 1987. On May 17, 1991, petitioner through its counsel protested the assessments and requested for their cancellation and revocation.

On January 6, 1993, respondent, through her Head, Revenue Executive Assistant (Collection), Director II, denied petitioner's protest on the alleged Deficiency Income Tax and Percentage Tax Assessments for failure on the part of petitioner to substantiate its allegations during the reinvestigation of its case. However, the Deficiency Documentary Stamps Tax Assessment for 1987 in the amount of P277,402.50, inclusive of 25% surcharge and compromise penalty, has been cancelled by the Commissioner of Internal Revenue. This constituted respondent's final decision on the matter which was received by petitioner on January 19, 1993. Thus, on February 16, 1993, petitioner filed an appeal by way of this Petition for Review.

The Deficiency Income and Percentage Tax Assessments against petitioner for the year ending December 31, 1987, in the sum of P302,823.79 and P9,377.73, respectively, are computed as follows:

DEFICIENCY INCOME TAX - 1987

Net Income per Return	P1,219,978.00
Add: Unallowable deduction	
1) Accounts written-off (No supporting papers)	430,135.41
Net Income per Investigation	P1,650,113.41

Tax Due Thereon	P 577,540.00
Less: Tax Due Per Return	426,992.00
Deficiency Income Tax	P 150,548.00
25% Surcharge	37,637.00
20% Interest fr. 4/16/88 to 3/15/91	106,638.79
Compromise Penalty	8,000.00
Amount Still Due	P 302,823.79

DEFICIENCY PERCENTAGE TAX - 1987

Penalties for late filing and payment of Percentage tax
(Second Quarter Amended)

Due Date (2nd Qtr.)	July 20, 1987
Date Paid	September 3, 1987
Basic Tax	P 15,276.00

25% Surcharge	P 3,819.00
20 % Interest fr. 7/20/87 to 3/15/91	2,558.73
Compromise	3,000.00
Amount Still Due	P 9,377.73

The issuance of the above-cited assessments were explained by the Revenue Examiner in her Memorandum for the Commissioner, dated July 6, 1990 (Exh. 2, pp. 163-166, BIR records). The Deficiency Income Tax Assessment resulted to the disallowance of bad debts written off by petitioner in December 1987, amounting to P430,135.41 on account of its failure to substantiate the same. While the Deficiency Percentage Tax Assessment was arrived at due to the late filing and payment of the additional percentage tax for the second quarter of 1987. The payment of percentage tax for the second quarter of 1987 was due on July 20, 1987 but the tax on the additional gross receipts as dealers in securities amounting to 6% of P254,600.00 or

P15,276.00 was paid only on September 3, 1987. Thus, for the late payment of the additional percentage tax, surcharge and interest was found due from petitioner pursuant to Section 248 of the Tax Code.

This was reiterated by the same Revenue Officer in her Memorandum Report, dated February 1, 1991, addressed to the Chief, Banks, Financing and Insurance Division, in response to the protest filed by petitioner, pertinent portion of said report reads as follows: (pp. 191-192, BIR records)

> "After going over the protest letter, the undersigned noted the following:
>
> 1) Deficiency Income Tax . . . . <u>P280,868.25</u>
>
> Subject taxpayer claimed as deduction bad debts written off which was disallowed by the undersigned in compliance with the requisites of deductibility of Bad Debts under Sec. 291 (sic) of the Tax Code which states that before a bad debt may be deducted from gross income, the following requisites must concur: (1) There must be an existing indebtedness; (2) Such debt must be ascertained to be worthless; and (3) Said debt must be actually charged off with (sic) the taxable year when it was ascertained to be worthless.
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> Subject taxpayer had not established either that debts are actually worthless or that it had reasonable grounds to believe them to be so.
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> 'It is noted that, in violation of Revenue Regulations No. 2, Section 102, respondent had not attached to its income tax return a statement showing the propriety of the deductions thereon made for alleged bad debts.' (Collector of Internal Revenue vs. Goodrich International Rubber Co., L-22265, Dec. 22, 1967, 21 SCRA 1336.)

As for the alleged documents presented as stated in their protest letter, the undersigned has not received any single document in relation to that issue considering the ample period of time given to them. All the related records and documents were attached herewith and were made as integral part of the docket.

2) x x x   x x x   x x x.

3) Penalties for late payment of
Percentage tax - P7,273.46

While it is true that the 2nd Quarter percentage tax return was filed on time and that the basis of the assessment was the amended return filed, Sec. 248 of Tax Code provides that - If the tax is not paid within the time prescribed for its payment, the amount of the tax shall be increased by a surcharge of twenty-five (25%) per centum, the increment to be part of the tax and the entire amount (tax & surcharge) shall be subject to interest at the rate of twenty (20%) per cent per annum. The said amount was being assessed for late payment of tax within the time prescribed for its payment."

As special and affirmative defenses, respondent, among others, alleged in her answer to the Petition for Review that the disallowance of bad debts expense in the amount of P430,135.41, was correct for failure on the part of petitioner to substantiate the same; that petitioner failed to establish the fact that the debts were actually worthless, pursuant to Section 102 of Revenue Regulations No. 2; that petitioner is liable to pay surcharge and interest due to the late payment of the additional percentage tax for the second quarter of 1987, pursuant to Section 248 of the

Tax Code; and that all presumptions are in favor of the correctness of the tax assessments issued.

The question posed itself as to whether or not the Deficiency Income and Percentage Tax Assessments has legal basis to stand on. As corollary issues the consequential questions particularly presented for resolutions are:

(1) Whether or not the disallowance by respondent of the claimed deduction for bad debts in the amount of P4,933.25 is proper; and

(2) Whether or not petitioner is liable to pay surcharge and interest for the late payment of the additional percentage tax for the second quarter of 1987.

We shall tackle the first corollary issue with respect to the disallowance of the bad debts expense claimed by petitioner in the amount of P430,135.41.

During the hearings conducted in this case, petitioner through its counsel manifested its conformity to the disallowance of the first three bad debts expense. Thus, limiting its argument to only one bad debt disallowance in the amount of P4,933.25, pertaining to the outstanding account of Mr. Felipe Ysrael, a client of petitioner.

It was ascertained during the hearing of October 13, 1993, that Mr. Felipe Ysrael has a margin of account with petitioner. A margin of account is an accommodation extended by petitioner to its clients whereby the latter buys shares of stocks to be financed by petitioner. The shares stands as collateral for the accommodation extended by petitioner to the buyer-client. The value of the securities bought is usually twice the amount of the margin accommodation. Mr. Ysrael's margin of accommodation with petitioner amounted to P118,384.94 plus an accrued interest of P19,707.32, or a total of P138,092.26. To satisfy the payment of the outstanding amount of P138,092.26, petitioner sold all the shares of Mr. Ysrael in Interport and Trans-Asia Securities for a consideration of P133,159.01. There remains a balance of P4,933.25 still unsatisfied, computed as follows: (Exh. B)

BPI SECURITIES CORP. - 1987

WRITE-OFF OF F. YSRAEL ACCOUNT:

Receivable	P118,384.94
Accrued Interest	19,707.32
Total	P138,092.26
Less, Proceeds of sale of Interport and Trans-Asia shares	133,159.01
Balance	P 4,933.25

This amount was written off as bad debt for the year 1987. To prove that the amount of P4,933.25 was correctly deducted as a bad debt expense from the gross income of petitioner, petitioner's counsel presented and offered the following evidence to substantiate the same:

1) Exh. A - Pro-forma Margin of Agreement between petitioner and its clients for the purpose of showing that petitioner extends credit to its customers whereby petitioner has

authority to unload or sell the securities bought by its customers when the value of these securities goes below a certain margin;

2) Exh. B - Computation of Bad Debt account of Mr. Felipe Ysrael to show how the amount of P4,933.25 was arrived at; and 3) Exh. C - BPI's Recommendation for Write Off, dated December 15, 1987, signed by one Mr. Malixi, Regional/Area/Dept./Div. Head of BPI, then Asst. Vice-Pres. of BPI Securities Corp. (Exh. C-1); and Exh. C-2 - The circumstance necessitating the deduction of P4,933.25 to show the steps taken before the write off of the unpaid balance of Mr. Ysrael, to wit:

> "COLLECTION EFFORTS TAKEN & PROSPECTS OF RECOVERY:
>
> Facts and information gathered showed that client is insolvent, and has no more leviable assets. Debit balance reached a high of P118,384.94. After reversal of accrued interest in suspense for P19,707.32 and selling of his Interport and Trans-Asia shares the balance is now down to P4,933.25."

What are the requisites for a valid deduction of bad debts? Section 30(e)(1) of the 1987 National Internal Revenue Code provides as follows:

> "**(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 31(b) of this Code."

The requisites for deductibility of bad debts are:

(1) There must be an existing indebtedness;

(2) The debt must be ascertained to be worthless as when the debtor is insolvent;

(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.

Before a taxpayer may charge off and deduct a debt, he must ascertain and be able to demonstrate, with a reasonable degree of certainty, the uncollectibility of the debt. The Commissioner of Internal Revenue will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor in determining whether a debt is worthless. Thus, where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of those facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction (Sec. 102, Rev. Regs. No. 2).

In the case of **Philippine Refining Company vs. Commissioner of Internal Revenue, CTA Case No. 4408, February 3, 1993**, we ruled:

> "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 future. So, where the recovery is merely doubtful, deduction will not be allowed. The following steps should be followed:
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> 1. sending of statements of accounts;
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> 2. sending of collection letters;
>
> 3. giving the account to a lawyer for collection; and
>
> 4. filing a collection case in court."

In the case at bar, the only evidence presented by petitioner to determine the worthlessness of the debt in question was the document marked as "Exh. C" - Recommendation for write-off. Petitioner alleged that the client is insolvent and has no more leviable assets. Considering that the amount was only minimal, the same was written off as a bad debt account. Petitioner in its letter to the BIR, dated August 17, 1990 (pp. 179-181, BIR records), alleged that it has on record documents to establish the worthlessness of the written-off accounts. It went further to state that cases were filed in Court against delinquent debtors after demands for payment were unjustifiably ignored.

According to petitioner, these documents are readily available for the BIR examiner's re-examination.

There is patently an absence of such document pointed out by petitioner. No letter of demand nor civil suits for collection were ever presented to the examiner nor to this Court except the Recommendation to Write-Off the account of Felipe Ysmael in the amount P4,933.25, being a very minimal amount. Nothing in the record will prove that indeed Mr. Felipe Ysmael is insolvent. If at all, the only reason why the account of Mr. Ysmael was written-off was because it involves a very minimal amount and to subject it to the rigidity of a collection suit would be highly impractical and inconvenient for petitioner. A debt is not worthless simply because it is of doubtful value or difficult for collection. **[White v. Comm., TC Memo 1971-13, 8 Mertens, Law of Federal Income Taxation, Chap. 30, p. 167, (1995).]**

The burden of proof is on the taxpayer to show not only that the debt is worthless but also that it became worthless during the taxable year. **(Caliguiuri v. Comm., 549 F2d 1155.)** The burden accorded the taxpayer can be overcome if the taxpayer can point to some certain event or events occurring within the taxable year which evidences the worthlessness of the debt. **(Hunsaker v. Comm., 615 F3d 1253.)** Many worthless debt deductions have been denied for failure of proof similar to the case on hand. Thus, for failure to overcome the burden of proof with respect to the worthlessness of the account of Mr. Felipe Ysmael the Court sees no reason why it has to reverse the findings of respondent with respect to the disallowance of bad debts resulting to the Deficiency Income Tax Assessment against petitioner for the year 1987. However, the Deficiency Income Tax Assessment for 1987, in the amount of P302,823.79, should be reduced by P8,000.00, representing the Compromise Penalty. No compromise agreement has been reached by both parties considering that this case was actually appealed to this Court. It is a well settled doctrine that compromise penalty cannot be imposed or collected without the agreement and conformity of the taxpayer. **(Collector of Internal Revenue v. University of Santo Tomas, et. al., G.R. Nos. L-11274 & L-11280, November 28, 1958, 104 Phil. 1062 Unrep.; the Collector of Internal Revenue v. Bautista, et. al., G.R. Nos. L-12250 & 12259, May 27, 1959, 105 Phil. 1326 Unrep.; The Philippines International Fair, Inc. v. Collector of Internal Revenue, G.R. Nos. L-12928 & L-12932, March 31, 1962, 4 SCRA 774; Wonder Mechanical Engineering Corporation represented by Mr. Lucio Quijano, President & General Manager, v. The Hon. Court of Tax Appeals and The Bureau of Internal Revenue being represented by The Commissioner of Internal Revenue, G.R. Nos. L-22805 & L-27858, June 30, 1975, 64 SCRA 555.)** The Deficiency Income Tax for 1987 should therefore be P294,823.79.

We now go to the second corollary issue of whether or not petitioner is liable to pay Deficiency Percentage Tax for late payment of its Additional Second Quarter Percentage Tax which was due on July 20, 1987 but was paid only on September 3, 1987.

There is no dispute that petitioner filed its original Second Quarter Percentage Tax Return on time, that is, on July 20, 1987. However, an amendment was later filed, on September 3, 1987 (Exh. D-1, p. 33, BIR record), indicating an additional Gross Receipts for the Second Quarter of 1987 in the amount of P254,600.00, representing income as dealer in securities. The corresponding tax of P15,276.00 was paid on September 3, 1987 under CB Confirmation Receipt No. B 12802126. However, petitioner contended that when it filed an Amended Percentage Tax Return on September 3, 1987, the Commissioner did not impose any surcharge, interest or compromise penalty. Petitioner added that an amendment is not synonymous to late filing.

We disagree with petitioner.

Section 16(a) of the National Internal Revenue Code gives the Commissioner of Internal Revenue the power to examine the returns filed and assess the correct amount of tax. , Likewise, Section 282(3) of the same Code provides for the imposition of 25% surcharge, as an addition to the tax, for failure to pay the tax within the time prescribed for its payment. In this case, the percentage tax of P15,276.00 paid on the additional gross receipts of P254,600.00, as dealer in securities, for the second quarter of 1987 should have been declared and paid on July 20, 1987 but the same was filed and paid only on September 3, 1987 which is way beyond the time prescribed by law. Therefore, respondent was correct in imposing the corresponding surcharge and interest. However, in connection with the discussion with respect to the compromise penalty in the Deficiency Income Tax Assessment for

1987, the Court adopts the same conclusion reached by the Supreme Court in the cases previously cited. Hence, petitioner cannot be subjected to pay the compromise penalty of P3,000.00, imposed by respondent in assessing it for Deficiency Percentage Tax in 1987, without its consent.

Petitioner in its last ditch to overturn the Deficiency Percentage Tax Assessment (issued on March 19, 1991) invoked prescription as its defense. It contended that the assessment was issued beyond the three (3) year period to assess under Section 268 of the National Internal Revenue Code. Respondent disputes this by presenting as evidence the Waiver of the Statute of Limitations (Exh. 3, p. 189, BIR record) showing that petitioner through its President signed the Waiver and duly accepted by respondent in order to stop the running of the prescriptive period to assess and to give ample time for the examiner to conduct a reinvestigation. Provided, however, that the period to assess, as agreed upon by the parties, shall not be later than March, 1991. The 1987 Deficiency Percentage Tax assessment notice was issued by respondent on March 19, 1991 still within the period agreed upon. This is bolstered by the fact that petitioner in a letter addressed to the BIR, dated July 30, 1991 (p. 218, BIR record), executed another Waiver (p. 217, BIR record), on July 30, 1991, valid up to January, 1992. With the waivers signed by petitioner, it cannot now invoke prescription on the period for respondent to assess. Section 271 of the National Internal Revenue Code is clear on this point, to wit:

> "SEC. 271. ***Suspension of running of statute.*** - The running of the statute of limitation provided in Sections 268 and 269 on the making of assessment and the beginning of distraint or levy or a proceeding in court for collection, in respect of any deficiency, shall be suspended for the period during which the Commissioner is prohibited from making the assessment or beginning distraint or levy or a proceeding in court and for sixty days thereafter; when the taxpayer requests for a reinvestigation which is granted by the Commissioner; when the taxpayer cannot be located in the address given by him in the return filed upon which a tax is being assessed or collected: *Provided*, That, if the taxpayer informs the Commissioner of any change in address, the running of the statute of limitations will not be suspended; when the warrant of distraint and levy is duly served upon the taxpayer, his authorized representative, or a member of his household with sufficient discretion, and no property could be located; and when the taxpayer is out of the Philippines."

WHEREFORE, in view of the foregoing, the petition for review is hereby **DISMISSED** for lack of merit. However, respondent's decision, dated January 6, 1993, is hereby **MODIFIED** with respect to the imposition of the compromise penalty there being no agreement to its imposition. Accordingly, petitioner is ordered to pay the respondent the amounts of P294,823.79, representing Deficiency Income Tax for 1987 and P6,377.73, representing Deficiency Percentage Tax for 1987, or a total of P301,201.52 plus 20% interest until the amount is fully paid, pursuant to Section 283(c)(3) [now 249(c)(3)] of the National Internal Revenue Code, as amended. Costs of suit against petitioner.

SO ORDERED.

MANUEL K. GRUBA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

RAMON O. DE VEYRA
Associate Judge

CERTIFICATION

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

ERNESTO D. ACOSTA
Court of Tax Appeals
Presiding Judge