LIB

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

ORANBO REALTY CORPORATION,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 5222

Promulgated:
APR 07 1997

x - x

DECISION

Before Us is petitioner's claim for the refund of excess and unutilized creditable expanded withholding tax (EWT) for the year 1992 in the amount of P973,014.00.

Petitioner is a domestic corporation organized and existing under Philippine laws. It is engaged in real estate business and its income consists principally of rentals from the leasing of its real property to its sole lessee, Aris Philippines, Inc.

The facts are simple.

On April 15, 1993, petitioner filed its Annual Income Tax Return (ITR for short) for the calendar year ended December 31, 1992 (Exh. "A"). It reflected a rental income of P19,480,721.00 (Exh. "A-2") and a 5%

creditable EWT thereon in the amount of P974,036.00 (Exhs. "A-1" and "B").

With only a tax due of P1,022.00 (Exh. "A", **supra**) minus the creditable EWT of P974,036.00, petitioner declared an excess income tax paid of P973,014.00 (Exh. "A-4"). Petitioner elected to have the latter amount refunded, as shown by an "x" mark on the appropriate box of the ITR.

On January 18, 1994, petitioner filed with respondent's Revenue District Office No. 47, East Makati, a letter requesting the respondent to refund or issue a tax credit certificate on the abovementioned overpaid income tax for 1992, resulting from the excess payment of creditable EWT of P973,014.00 (Exh. "D"). In said letter, petitioner averred that the overpayment was not claimed nor used as a tax credit against its income tax liability for the succeeding year - 1993, because it had no taxable income or taxable liability for that year.

Petitioner waited for respondent's action. None was forthcoming. Bearing in mind that a claim for refund can only be maintained in this Court within a two-year period from the date of payment of the tax or penalty regardless of any supervening cause that may arise after payment as provided under Section 230 of the Tax Code, as amended, petitioner moved to suspend the running of the prescriptive period.

Hence, this appeal on April 3, 1995.

Petitioner reasserts its stance *a quo* and adds that it has not claimed the overpaid income tax as credit against income tax liabilities for any succeeding taxable quarter(s) or taxable year.

Respondent, on the other hand, asseverates in her answer, *inter alia*, the special and affirmative defenses that petitioner's claim for refund or tax credit is pending administrative investigation and that it is incumbent upon the petitioner to show its compliance with the provisions of Section 230 of the Tax Code, as amended.

Records reveal that respondent's revenue officers conducted a belated investigation on petitioner's claim for refund pursuant to a Letter of Authority (No. 86030), dated October 2, 1995 (Exh. "1"). As a result, they came up with the hereunder quoted report, to wit:

"Facts and Findings:

Oranbo Realty Corporation has outstanding loans from various companies. Said loans are enumerated below:

BPI	-	July 1989	P40,000,000.00
UCPB	-	August 1990	27,000,000.00
Aris Phils.	-	Various	26,878,435.00

The above loans were used in the acquisition of real [e]state and shares of stocks, correspondingly interest were incurred and paid by the subject taxpayer. Interest expense were charged and paid to the following:

BPI	P 8,973,972.58
UCPB	5,638,411.62
Arls Phils.	3,289,905.20
	P17,902,289.40

The above interest expense was part of the deductions claimed by the subject taxpayer as operating expenses amounting to P19,484,337.00 for the year 1992. it is also the subject of disallowance by the undersigned Revenue Officer for the following reasons:

1.) Loan with BPI - The purpose of these loans was intended in acquiring all outstanding shares of stock by NOMA Dev't. Corp. (see term loan agreement). Financial statements for the year[s] 1990-1991, however, do not reflect such transaction, its disposition and the result of the said disposition.

Furthermore, the loans obtained was supposed to have been used to purchase shares of stock which is not in proper course of trade and business of the subject taxpayer. Cost and expenses attributed to the said transaction should not be applied with the income arising from lease of real estate.

2.) Loan from UCPB - The proceeds from these loans were used to acquire land amounting to P25,821,745.00. (see statement of changes in financial position - 1990). Since real estate was purchased all on the said loan, all other expenses attending to the acquisition of capital asset should also be capitalize. The rationale behind this rule is that land in most instances appreciates and that cost pertaining to such acquisition should not be charged to operation but rather be capitalize to determine the real purchase value.

3.) Due to Arls Phils. - Again, most of the loans obtained by the subject taxpayer from

Aris Phils., were used to acquire real properties except for the [one] dated May 5, 1988 which was intended to finance purchase of shares of capital stock of NOMA Dev't. Corp. The position of the undersigned is that interest expense should be disallowed based on the arguments stated above.

Moreover, the subject taxpayer and Aris Phils. are related taxpayers. On the loan transaction entered into by subject taxpayer with BPI, Mr. Rolf H. Schroeder acted as chairman of the board by the former, while on all transactions entered into by Aris Phils., with the subject taxpayer Mr. Rolf H. Schroeder was the President of Aris Phils.

As a result of the disallowances Oranbo Realty Corp. is still liable for income tax in the amount of P10,107,023.98, computation is shown below:

Taxable income		P 2,920.00
Add: Interest		17,902,289.40
Taxable Income per Investigation		P17,905,209.40
Taxable Due		P 6,266,823.29
Less: Tax Credits		974,036.36
Deficiency Income Tax		P 5,292,786.93
Add:	Surcharge	1,323,196.73
	Interest	3,466,040.32
	Compromise fee	25,000.00
		P10,107,023.98

In view thereof, it is respectfully recommended that the claim for refund be denied, and the issuance of a demand notice be sent to the subject taxpayer, to enforce collection on the proposed deficiency, income tax." (Underscoring supplied; pp. 1-3, Exh. "2"; pp. 96-98, CTA records)

The issues besetting Us may thus be limited to the following:

1) Whether or not the findings of said revenue officers, *as adopted and presented by the respondent in this proceeding*, provide meritorious considerations to her position of contesting herein claim for refund; and, if in the negative,

2) Whether or not petitioner has surmounted the ***onus probandi*** required by law and the rules in sustaining and proving its claim for refund.

On the first issue, We are not impressed at all with respondent's posturing.

As regards the loan with the Bank of the Philippine Islands, petitioner correctly remarked by citing our previous ruling in **Oranbo Realty Corporation vs. CIR, CTA Case No. 4820, January 23, 1995,** involving the same parties herein, that the reason why its financial statements for the year 1990-1991 did not reflect the acquisition of all the outstanding shares of stock of NOMA Development Corp. was simply due to the fact that the latter corporation was "liquidated earlier in 1989 and therefore the investment in shares was replaced by real estate assets (by way of liquidating dividends) in petitioner's statements beginning 1990" (p. 8, Petitioner's Memorandum; p. 156, CTA records). Verily, such real estate assets are necessary in petitioner's real estate leasing operations.

Respondent also assails petitioner's treatment of the interests on loans it obtained with the Bank of the Philippine Islands (BPI), United Coconut Planters Bank (UCPB) and Aris (Phils.), Inc. as interest expense deductible from gross income. She contends that the same should be capitalized because "land in most instances appreciates and that cost pertaining to such acquisition should not be charged to operation but rather be capitalized to determine the real purchase value (Exh. "2", supra).

We deem respondent's preceding ratiocination to be anchored on hollow grounds. In refutation, We are of the opinion that the case of **PAPER INDUSTRIES CORP. OF THE PHILS. (PICOP) vs. COURT OF APPEALS, COMMR. OF INTERNAL REVENUE AND COURT OF TAX APPEALS, G.R. Nos. 106949-50; and COMMR. OF INTERNAL REVENUE vs. PICOP, THE COURT OF APPEALS AND THE COURT OF TAX APPEALS, G.R. Nos. 106984-85, December 1, 1995, decided by the Supreme Court *En Banc***, which although it involves the allowance of interest on loans for the purchase of machinery and equipment as a deduction from gross income, nevertheless, may apply to interests paid on loans contracted from: (1) Aris (Phils.), Inc., to acquire real properties (Exhs. "5-a", "6-a" and "7-a") and shares of stocks of NOMA Development Corp. (Exh. "8-a"), an entity also engaged in the real estate business; (2) UCPB to finance its working capital (Exh. "4"); and (3) BPI to refinance the acquisition of all outstanding shares of stock of NOMA Development Corp.. The Said decision insofar as pertinent provides:

> **"(1) Whether Picop is entitled to deduct against current income interest payments on loans for the purchase <u>of machinery and equipment</u>.**
>
> In 1969, 1972 and 1977, Picop obtained loans from foreign creditors in order to finance the purchase of machinery and equipment needed for its operations. In its 1977 Income Tax Return, Picop claimed interest payments made in 1977, amounting to P42,840,131.00, on these loans as a deduction from its 1977 gross income.
>
> The CIR disallowed this deduction upon the ground that, because the loans had been incurred for the purchase of machinery and equipment, the interest payments on those loans should have been capitalized instead and claimed as a depreciation deduction taking into account the adjusted basis of the machinery and equipment (original acquisition cost plus interest charges) over the useful life of such assets.
>
> Both the CTA and the Court of Appeals sustained the position of Picop and held that the interest deduction claimed by Picop was proper and allowable. In the instant Petition, the CIR insists on its original position.
>
> We begin by noting that interest payments on loans incurred by a taxpayer (whether BOI-registered or not) are allowed by the NIRC as deductions against the taxpayer's gross income. Section 30 of the 1977 Tax Code provided as follows:

> "Section 30. Deduction from Gross Income. The following may be deducted from gross income:
>
> (a) Expenses:
>
> xxx xxx xxx
>
> (b) Interest:
>
> (1) In general. - The amount of interest paid within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations the interest upon which is exempt from taxation as income under this Title: x x x" (Underscoring supplied)

Thus, the general rule is that interest expenses are deductible against gross income and this certainly includes interest paid under loans incurred in connection with the carrying on of the business of the taxpayer. In the instant case, the CIR does not dispute that the interest payments were made by Picop on loans incurred in connection with the carrying on of the registered operations of Picop, i.e., the financing of the purchase of machinery and equipment actually used in the registered operations of Picop. Neither does the CIR deny that such interest payments were legally due and demandable under the terms of such loans, and in fact paid by Picop during the tax year 1977.

The CIR has been unable to point to any provision of the 1977 Tax Code or any other statute that requires the disallowance of the interest payments made by Picop. The CIR invokes Section 79 of Revenue Regulations No. 2 as amended which reads as follows:

> "Section 79. Interest on Capital. - Interest calculated for cost-keeping or other purposes on account of capital surplus invested in the business, which does not represent a charge arising under an interest-bearing obligation, is not

> allowable deduction from gross income." (Emphases supplied)

We read the above provision of Revenue Regulations No. 2 as referring to so called "theoretical interest," that is to say, interest "<u>calculated</u>" or computed (and not <u>incurred</u> or <u>paid</u>) for the purpose of determining the "opportunity cost" of investing funds in a given business. Such "theoretical" or imputed interest does <u>not</u> arise from a legally demandable interest-bearing obligation incurred by the taxpayer who however wishes to find out, e.g., whether he would have been better off by lending out his funds and earning interest rather than investing such funds in his business. One thing that Section 79 quoted above makes clear is that interest which does constitute a charge arising under an interest-bearing obligation <u>is</u> an allowable deduction from gross income.

It is claimed by the CIR that Section 79 of Revenue Regulations No. 2 was "patterned after" paragraph 1.266-1 (b), entitled "Taxes and Carrying Charges Chargeable to Capital Account and Treated as Capital Items" of the U.S. Income Tax Regulations, which paragraph reads as follows:

> "(B) <u>Taxes and Carrying Charges.</u> - the items thus chargeable to capital accounts are -
>
> (11) In the case of real property, whether improved or unimproved and whether productive or nonproductive.
>
> (a) Interest on a loan (but not theoretical interest of a taxpayer using his own funds)."

The truncated excerpt of the U.S. income Tax Regulations quoted by the CIR needs to be related to the relevant provisions of the U.S. Internal Revenue Code, which provisions deal with the general topic of adjusted basis for determining allowable gain or loss on sales or exchange of property and allowable depreciation and depletion of capital assets of the taxpayer:

> "Present Rule. The Internal Revenue Code and the Regulations promulgated thereunder provide that 'No deduction shall be allowed for amounts paid or accrued for such taxes and carrying charges as, under regulations prescribed by the Secretary or his delegate, are chargeable to capital account with respect to property, if the taxpayer elects, in accordance with such regulations to treat such taxes or charges as so chargeable.'
>
> At the same time, under the adjustment of basic provisions which have just been discussed, it is provided that adjustment shall be made for all 'expenditures, receipts, losses, or other items' properly chargeable to a capital account, thus including taxes and carrying charges; however, an exception exists, in which event such adjustment to the capital account is not made with respect to taxes and carrying charges which the taxpayer has not elected to capitalize but for which a deductions instead has been taken." (Underscoring supplied)

The 'carrying charges' which may be capitalized under the above quoted provisions of the U.S. Internal Revenue Code include, as the CIR has pointed out, interest on a loan '(but not theoretical interest of a taxpayer using his own funds)'. What the CIR failed to point out is that such 'carrying charges' may, either be (a) capitalized in which case the cost basis of the capital assets, e.g., machinery and equipment, will be adjusted by adding the amount of such interest payments or, alternatively, be (b) deducted from gross income of the taxpayer. Should the taxpayer elect to deduct the interest payments against its gross income, the taxpayer cannot at the same time capitalize the interest payments. In other words, the taxpayer is not entitled to both the deduction from gross income and the adjusted (increased) basis for determining gain or loss and the allowable depreciation charge. The U.S. Internal Revenue Code does not prohibit the deduction of interest on a loan obtained for purchasing machinery and equipment against gross income, unless the taxpayer has also or previously capitalized the same interest payments and thereby adjusted the cost basis of such assets.

We have already noted that the 1977 NIRC does not prohibit the deduction of interest on a loan incurred for acquiring machinery and equipment. Neither does our 1977 NIRC compel the capitalization of interest payments on such a loan. The 1977 Tax Code is simply silent on a taxpayer's right to elect one or the other tax treatment of such interest payments. Accordingly, the general rule that interest payments on a legally demandable loan are deductible from gross income must be applied.

The CIR argues finally that to allow Picop to deduct its interest payments against its gross income would be to encourage fraudulent claims to double deductions from gross income:

> '[t]o allow a deduction of incidental expense/cost incurred in the purchase of fixed asset in the year it was incurred would invite tax evasion through fraudulent application of double deductions from gross income.' (Emphases supplied)

The Court is not persuaded. So far as the records of the instant cases show, Picop has not claimed to be entitled to double deduction of its 1977 interest payments. The CIR has neither alleged nor proved that Picop had previously adjusted its cost basis of the machinery and equipment purchased and claim, e.g., increased deductions for depreciation.

We conclude that the CTA and the Court of Appeals did not err in allowing the deductions of Picop's 1977 interest payments on its loans for capital equipment against its gross income for 1977."

On the allegation that herein petitioner and Aris Phils., Inc. are related taxpayers, which if true would disallow the deduction of the subject interest expense pursuant to Section 29(b)(2)(ii) of the Tax Code, as amended, We bewail such improvident and uncanny conclusion reached by the respondent in the absence of facts clearly and undeniably establishing ownership composition of the two corporations.

Section 29(b)(2)(ii) in relation to Section 30(b) of the Tax Code, as amended, provide as follows:

> **"SEC. 29. Deductions from gross income. - xxx.**
>
> (a) *Expenses*:
>
> x x x
>
> (b) *Interest*:
>
> x x x
>
> (2) No deduction shall be allowed in respect of interest under the succeeding sub-paragraphs:
>
> (i) x x x
>
> (ii) If both the taxpayer and the person to whom the payment has been made or is to be made are persons specified under Section 30(b)."

"SEC. 30. **Items not deductible.** (a) *General rule.* - In computing taxable income no deduction shall in any case be allowed in respect of -

x x x x x x x x x

(b) *Losses from sales or exchanges of property.* - in computing net income no deduction shall in any case be allowed in respect of losses from sales or exchanges of property, directly or indirectly -

(1) Between members of a family. For the purposes of this paragraph, the family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants;

(2) Except in the case of distributions in liquidation, between an individual and a corporation more than fifty *per centum* in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(3) Except in the case of distributions in liquidation, between two corporations more than fifty per centum in value of the outstanding stock of each of which is owned, directly or indirectly, by or for the same individual, if either one of such corporations, with respect to the taxable year of the corporation preceding the date of the sale or exchange was, under the law applicable to such taxable year, a personal holding company or a foreign personal holding company;

(4) Between a grantor and a fiduciary of any trust;

(5) Between the fiduciary of a trust and the fiduciary of another trust, if the same person is a grantor with respect to each trust; or

(6) Between a fiduciary of a trust and a beneficiary of such trust." (Underscoring ours)

Respondent simply failed to prove her allegation. Mr. Rolf H. Schroeder, being the concurrent President of Aris (Phils.), Inc. and the Chairman of the Board of herein Petitioner does not mean or may it in any way be deduced that he has controlling ownership of such corporations. Respondent failed to present any evidence with respect to the percentage of ownership of Mr. Schroeder on the outstanding capital stock of said corporations. A more circumspect investigation of petitioner's claim for refund or tax credit should have been undertaken in the interest of fair play and speedy administration of justice.

In fine, respondent's overall opposition to herein claim for refund or tax credit is manifestly untenable and without any legal basis.

With respect to the second issue, We are fully convinced that petitioner has seasonably filed this petition and duly proven its claim for refund or tax credit based on the evidence on record.

Petitioner has complied with the jurisdictional requisite for the filing of its petition within the two-year period from date of payment of the tax, as required by Section 230 of the Tax Code, as amended. It filed its Income Tax Return (ITR) on April 15, 1993. The claim for refund or tax credit with the BIR was filed on January

18, 1994 and this case was filed on April 3, 1995. Both claims were filed well within the period prescribed by law. Respondent's allegation that the claim is still pending investigation is of no moment. Petitioner has to elevate its case before this Court within the peremptory two-year period, otherwise the claim will be barred forever. Petitioner need not wait for the action of the Commissioner on the claim for refund before taking its claim for refund or credit to Court (**Sweeney vs. Collector, L-12178, Aug. 21, 1959; P.J. Kiener Co. vs. David, L-5163, April 23, 1953; College of Oral and Dental Surgery, L-10446, Jan. 28, 1958; Comm. vs. Victoria Milling Co., 22 SCRA 12; Gibbs vs. Collector, L- 134453, Feb. 29, 1960**).

On the intrinsic merit of petitioner's claim for refund or tax credit of excess and unutilized creditable Expanded Withholding Tax (EWT) for the year 1992, petitioner has fully satisfied the legal requisites for a successful claim for refund or tax credit, namely:

1) The fact of withholding is established by a copy of the statement duly issued by the payor to the payee showing the amount of income paid and the amount of tax withheld therefrom [Section 51(c) of the Tax Code, as amended; **Citytrust Finance Corp. vs. CIR, CTA Case No. 4134, dated November 11, 1991**];

2) It must be shown in the return of the recipient that the income received was declared as part of gross income [Section 51(f), ibid.];

3) The taxpayer filed in writing with the Commissioner a claim for credit or refund within two years after the payment of the tax or penalty (**ibid**);

4) The taxpayer elected to have its overpaid income taxes refunded as shown in the appropriate box of its ITR (**Paseo Realty and Development Corporation vs. Commissioner of Internal Revenue, CA-G.R. SP No. 33589, October 14, 1994**).

On the first requisite, petitioner submitted the Certificate of Creditable Income Tax withheld at Source (BIR Form No. 1743.1) issued to it by Aris (Phils.) Inc. (Exh. "B"). This is in conformity with Section 6 of Revenue Regulations No. 6-85, the Revised and Consolidated Expanded Withholding Tax Regulations which clearly mentions the aforementioned statement duly issued by the withholding agent/payor to be that of BIR Form No. 1743.1 (see also **Citytrust Finance Corporation vs. CIR, CTA Case No. 4134, supra**). Petitioner also submitted the Monthly Remittance Returns of Income Taxes Withheld (BIR Form 1743 W) filed by Aris (Phils.) Inc. for the months of January to December 1992 (Exhs. "E" to "P", inclusive) together with their corresponding Schedules of Income

Recipients, Income Received and the Tax Withheld by them (Exhs. "E-2" to "P-2", inclusive of their submarkings) to further bolster its claim that the total amount of P974,036.36 has actually been withheld by Aris (Phils.) Inc. and that the same have been remitted to the BIR.

With respect to the second and third requisites, petitioner, as noted already in the facts of this case, declared the entire rental income subject of herein claim for refund in its ITR in the amount of P19,480,721.00 (Exh. "A-2"), and filed its letter-claim for refund/tax credit with the Commissioner on January 18, 1994 (Exh. "D") which, when reckoned with the payment of the tax on April 15, 1993 (Exh. "A") and the filing of the instant petition on April 3, 1995, the same is found to be well within the two-year period.

Lastly, on the fourth requisite, petitioner's ITR readily shows the fact that an "x" mark has been placed on the appropriate box for refund of overpaid income taxes.

In conclusion, petitioner has adequately proven its case before this Court. The hardships it has endured as a result of the inaction of the respondent on its administrative claim and the belated opposition the same has thrown over its petition must now end.

WHEREFORE, in view of the foregoing premises, the instant Petition for Review is hereby **GRANTED**. Accordingly, respondent is hereby directed to **REFUND or in the alternative issue a TAX CREDIT CERTIFICATE** in favor of petitioner the sum of P973,014.00, representing overpaid income tax for the year 1992 as a result of excess and unutilized expanded withholding tax for the same year. No pronouncement as to cost.

SO ORDERED.

RAMON O. DE VEYRA
Associate Judge

I CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

CERTIFICATION

I hereby certify that this 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
Court of Tax Appeals