REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PHILEX MINING CORPORATION,
Petitioner,

- versus -

C.T.A. CASE NO. 5200

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
AUG 21 1998

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DECISION

Before us for consideration is a petition for review filed by the petitioner seeking the reversal of respondent's final decision on a disputed assessment involving the amount of ₱62,811,161.39 resulting from the disallowance from its gross income of an alleged loss on settlements of receivables from Baguio Gold Mining Company ("Baguio Gold" for brevity) amounting to ₱112,136,000.00.

Petitioner is a domestic corporation duly organized and existing under Philippine laws, with principal office at Philex Building, Brixton and Fairlane Streets, Pasig, Metro Manila. It is engaged in the business of mining, exporting and/or selling gold, copper concentrates and other mining products. As such, it has extensive experience in the exploration, exploitation and operation of mining claims, one of which is called the "Sto. Niño Mine", once owned by Baguio Gold, located in the Municipalities of Atok and Tublay, Province of Benguet.

The case at bar arose when petitioner agreed to undertake the management of the Sto. Niño Mine from Baguio Gold, pursuant to a document denominated as "Power of Attorney" executed on April 16, 1971. The agency encompassed the doing of all things necessary and proper to bring about the successful management of said mine and the maintenance of the same as a commercially profitable venture. It included, *inter alia*, the authority for the petitioner, whenever convenient and necessary, to make advances or to transfer its own funds or property for the operation of the mine. Pursuant to such authority, petitioner made substantial advances and transferred its own funds and property to the mine.

It is alleged, however, that the mine suffered continuing losses in its operations which resulted in Baguio Gold being declared in technical default of its U.S. $8,000,000.00 loan as of December 31, 1981 and the petitioner withdrawing as manager of the mine on January 28, 1982. The mine eventually ceased operations on February 20, 1982.

In the ensuing settlement of accounts, Baguio Gold allegedly recognized its indebtedness to the petitioner. After an initial agreement, an Amended Compromise with *Dation* in Payment was finally executed by them on December 31, 1982. Under the Amendment, Baguio Gold's liability to the petitioner was determined at ₱259,137,245.00, which included the liabilities of Baguio Gold to other creditors that were assumed by the petitioner amounting to U.S.$11 million. Out of such amount, Baguio Gold agreed to pay petitioner ₱144,140,477.00 worth of tangible and valuable assets, broken down into two segments. The first segment amounting to ₱127,838,051.00 was paid through assets while the second segment amounting to ₱16,302,426.00 was settled by the transfer to the petitioner of Baguio Gold's equitable title in its Philodrill assets.

The remaining outstanding indebtedness of Baguio Gold to the petitioner, thus, amounted to ₱114,996,768.00 which was written off in the books of the latter in 1982 by a charge of ₱112,136,000.00 to allowance and reserves that were set up in 1981 and by a charge of ₱2,860,768.00 to the 1982 operations.

In its 1982 annual income tax return, petitioner deducted from its gross income the amount of ₱112,136,000.00 as "loss on settlement of receivables

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from Baguio Gold against reserves and allowances." Respondent's Bureau, however, disallowed the amount as a deduction. Consequently on October 7, 1988, petitioner received from the respondent an assessment notice designated as FAS-1-82-88-003067 dated September 30, 1988 for deficiency income tax in the amount of ₱62,811,161.39.

Petitioner filed a letter of protest, dated October 10, 1988, on the assessment. It adopted as part of its protest its previous letter, dated May 8, 1988, wherein it interposed legal and factual arguments against the finding of respondent that Baguio Gold's indebtedness has not been ascertained to be actually worthless, hence, not deductible. In particular, petitioner alleged in said letter the underlying bases for the respondent's finding, to wit:

> 1. That the president of the taxpayer-Corporation, Mr Henry Brimo, is likewise the president of the debtor Baguio Gold Mining Co.;
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> 2 That the collateral/assets given by the debtor Baguio Gold Mining Co. to the taxpayer-Corporation should first be disposed of or sold, before there can be any loss or bad debt;
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> 3. That the debtor continues to hold office and has not filed any petition in bankruptcy before any court or government office.

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Petitioner disagreed with the above conclusions. Firstly, it contended that the indebtedness arose out of a valid management contract between Baguio Gold and itself because under Section 44 of the Corporation Code of the Philippines, two corporations with interlocking directors are allowed to enter into a management contract whereby one delegates the management of its business affairs to the other for a certain period of time.

Secondly, petitioner emphasized that the bad debt deduction of ₱112,136,000.00 came from its advances made in favor of Baguio Gold pursuant to the management contract, and the payments it had assumed and made as guarantor of Baguio Gold.

On the recovery of the alleged bad debt, petitioner cited the case of **Iowa Southern Utilities Co. vs. U.S., 346 F2d 492**, in asseverating that a debt is considered worthless, if, under subjective circumstances at the time the purported obligation is created, a 'reasonably prudent person' would not have expected repayment from the debtor; that a taxpayer may exercise sound business judgment based upon information reasonably obtainable in determining worthless debts; and that a taxpayer may not postpone a bad debt deduction on the basis of a mere hope of ultimate collection.

Petitioner noted that in several cases[1], this Court, in allowing bad debt deductions, had held that it is not necessary for the taxpayer to institute a judicial action against the debtor in order to determine worthlessness of a debt; that it is enough that the taxpayer exerted diligent effort to enforce collection and exhausted all reasonable means of collecting debt; and that, the taxpayer is not required to be an 'incorrigible optimist' in enforcing collection of a debt.

As a guarantor, petitioner contended that under Articles 2066-2067 of the Civil Code of the Philippines, it was obligated to pay for the loan obligations of Baguio Gold if the latter is not able to pay; and that, by legal subrogation, it steps into the shoes of the original creditor upon payment. It added that when a taxpayer has a loss arising from the guaranty of a loan, it is entitled to a bad debt deduction[2].

Thirdly, petitioner claimed that as a rule, it is not necessary that collateral assets be actually sold or

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[1]Western Pacific Corp. vs. Commissioner of Internal Revenue, CTA Case No. 720, May 22, 1961; Goodrich International Rubber Co. vs. Collector of Internal Revenue, CTA Case No. 468, June 8, 1963; ESSO Standard Eastern, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 1530, November 11, 1968

[2]Mertens, Vol. 3, 30.8 and the cases of Martin vs. Comm., 38 TC 188, 1962; Putnam vs. Comm., 352 US 8, 1 L Ed2d 144; Thomas Watson, 8 TC 569; and Stratmore vs. US, 420 F2d 461.

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disposed of as a prerequisite to a bad debt deduction; and that the rule applies irrespective of whether the security is unsalable or whether it is merely expedient to sell the collateral, citing the cases of **67 Ross vs. Comm., 72 F2d 122 CCA7, 1934** and **Freiberg vs. Comm., BTA Memo Op Dkt 35614, 1938**.

Petitioner underscored the cases of **Colvert vs. Comm., 6 BTA 623** and **Giepen vs. Comm., TC Memo 1957-6** respectively, in pointing out that worthlessness may be readily demonstrated where payment of the debt is limited to the collateral, or where the collateral represents the only assets which the debtor has available, to pay his debts; and that the value of the security must be offset against the indebtedness before any deduction for a worthless, or a partially worthless debt, can be allowed.

On the value of such security or collaterals, petitioner cited the cases of **First National Bank, Philipsburg, Pennsylvania vs. CIR, 43 BTA 456** and **National Farmer's Bank vs. Comm., 6 BTA 138**, in arguing that their fair market value shall be the one used in determining worthlessness of a debt.

In proving its claim of bad debt deduction, thus, petitioner attached the independent appraisal conducted by Asian Appraisal Co., Inc. on the fair market value of the net assets of Baguio Gold.

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Lastly, petitioner contended that neither the absence of any position for bankruptcy nor the continued existence of Baguio Gold affects the validity of the bad debt deduction it has made.

It asseverated, from among other cases[3], that the date of worthlessness of a debt is fixed by identifiable events which form the basis of reasonable grounds for abandoning any hope for the future[4]; that, the time a debt becomes worthless is a question of fact, the determination of which requires a practical approach that is flexible in nature and based upon the exercise of sound business judgment[5]; that to be deductible, a debt need not be proven worthless beyond peradventure, since a bare hope that something might be recovered in the future constitutes no sound reason for postponing the time for taking a deduction[6]; and that, the taxpayer is not

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[3]Boehm vs. Comm., 326 US 287, 34 AFTR 10; Minneapolis, St. Paul & SS MR Co. vs. US, 13 AFTR 2d 472; Bruce vs. Green, TC Memo, 1976-127; Allen vs. Edwards, 114 F Supp. 672; Blair vs. Comm., 91 F2d 992; Hammerschmidt & Franzen Co. vs. CIR, 12 BTA 811; Midland Coal vs. Comm., 1 BTA 311,313; Jones vs. Comm., 38 F2d 550; Lelandais vs. Comm., TC Memo 1976-345; Montgomery vs. Comm., 37 BTA 232; Paramount Liquor Co. vs. Comm., 242 F2d 249; and, Thom vs. Burnet, 55 F2d 1039

[4]W.A. Dallmayer, 14 TC 1282

[5]Acheson vs. Comm., 155 F2d 369 and Boehm vs. Comm., 326 US 287, 34 AFTR 10

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required to postpone his entitlement to a deduction in the expectancy of uncertain future events nor is he called to wait until some turn of the wheel of fortune may bring the debtor to affluence[7].

Respondent, however, denied with finality petitioner's letter of protest in a letter, dated October 28, 1994, which was allegedly received by the petitioner on January 19, 1995 and ruling therein that Baguio Gold has no existing and valid debt to the petitioner and that the debt was not ascertained to be worthless, following the requisites provided under Section 30 (e) of the Tax Code, as amended. Hereunder quoted is the letter of denial sent by the respondent to the petitioner, to wit:

October 28, 1994

Sycip, Gorres, Velayo & Co.
Certified Public Accountants
6760 Ayala Avenue, Makati
Metro Manila

Attention: W.E. Sanchez
Tax Division

Gentlemen:

This refers to your protest filed on behalf of your client, PHILEX MINING CORPORATION, against assessment involving the amount of ₱62,811,161.39 representing deficiency income tax for 1982. In this connection,

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[6]Minneapolis, St. Paul & SS MR Co. vs. US, 13 AFTR 2d 472

[7]Ibid.

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please be informed that after a careful review of the facts of the case as well as the law and jurisprudence applicable thereto, we find your protest to be untenable and devoid of merit.

Re: Bad Debts-Unascertained Worthlessness

The above assessment was based on the disallowance of the alleged loss on settlements of receivables from Baguio Gold Mining Company in the amount of ₱112,136,000.00.

It is your contention that the bad debts deduction of ₱112,136,000.00 meets all the requirements for its deductibility under Section 30(e) of the Tax Code and hence should not have been disallowed as the indebtedness arose out of a valid management contract entered into by herein taxpayer Philex Mining Corporation and Baguio Gold Mining Company and that such bad debts was actually charged off in the taxable year it was determined by the taxpayer corporation to be worthless.

It is our contention that the disallowed bad debt accounts did not meet the requisites as provided for under Section 30(e) based on the following reasons:

1. There was no valid and existing debt

It is alleged that the bad debt deduction of ₱112,136,000.00 arose out of the taxpayer corporation's advances made in favor of Baguio Gold Mining Co. pursuant to the Power of Attorney (management contract) executed between the parties on April 16, 1971 and the taxpayer's payments as guarantor of Baguio Gold Mining Company in respect of its U.S. $11 Million loan obtained from Citibank.

A close perusal of the alleged management contract shows that there was no valid and subsisting debt as between the parties as the agreement provides that the alleged debtor Baguio Gold Mining Company was to pay herein taxpayer Philex Mining Company the compensation of fifty percent (50%) of the net profit of the Sto. Niño project before income tax, and not the alleged advances. It is our view that this is not deductible even if written off as bad debt as this cannot be considered as a valid and subsisting debt the collection of which may be enforced in a Court of law (Fernandez Hermanos vs. Comm. L-21551 & L-21557, September 30, 1969).

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2. The alleged bad debt was not ascertained to be worthless.

Before a debt can be ascertained to be worthless, the creditor must take reasonable steps to collect the debt within a reasonable period of time. It must be able to demonstrate that the debt is not only collectible but also appears to be uncollectible at any time in the future, Usually, the action taken includes the following: sending of statement of accounts; sending of collection letters; giving the account to a lawyer for collection; and filing a collection case in court. No such actions appears to have been taken by the corporation. Verification made by the investigating examiners likewise shows that the debtor Baguio Gold Mining Company is still existing and has not filed any petition for bankruptcy in any court or government offices. Nor was there any showing or proof that it was insolvent.

3. It is likewise a settled rule that before a write off account is allowed, this receivable must be ascertained to be worthless and unless substitutes or collaterals are given by the debtor (Baguio Gold Mining), the assets/securities received stand in place of the debt. The determination of loss in such case is deferred until the disposal of the property.

Accordingly, your protest is hereby denied for lack of legal and factual basis.

In view thereof, it is requested that you urge your client to pay the total amount of ₱62,811,161.39 within twenty (20) days from receipt hereof, otherwise the collection thereof will be enforced by means of the summary remedies provided by law.

This constitutes our final decision on the matter.

Very truly yours,

LIWAYWAY VINZONS-CHATO
Commissioner of Internal Revenue

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With such denial, petitioner was constrained to elevate its case before this Court. Hence, this appeal filed on February 17, 1995.

At bar, petitioner reasserts its stance *a quo*. It contends in its petition, *inter alia*, that the advances it made to the Sto. Niño Mine is in the nature of a loan. It explains, thus:

> 5. That the advances made by Philex is in the nature of a loan is further shown by the fact that after Philex transferred its funds or property to the Sto. Niño Project, the same ceased to be funds or property of Philex. The ratio which the funds and property transferred by Philex has to Baguio Gold's account has to be determined upon the termination of the agreement, and "the corresponding proportion of the entire assets of the Sto. Niño Mine" had to be transferred to Philex in return for the funds and property.
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> 6. The existence of the indebtedness of Baguio Gold to Philex, not only with respect to the advances and transfer of funds or properties but also for other liabilities of Baguio Gold which Philex assumed, is further shown by the subsequent Compromise and the Amendment which Philex and Baguio Gold executed on 3 November 1982 and 31 December 1982, respectively. x x x
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> x x x x x x x x x
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> 8. The finding of the respondent that there is no existing indebtedness because Baguio Gold was to pay Philex "compensation of fifty percent (50%) of the net profit of the Sto. Niño project before income tax, and not the alleged advances", is erroneous. Philex did not write off the compensation that it expects to receive from the Sto. Niño Project. It must be clarified that what Philex is

> writing off as a bad debt is the amount of the advances it made to the Sto. Niño Mines and the payment it made as guarantor of the Baguio Gold's loans.
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> 9. The case [of] Fernandez Hermanos v. Commissioner (29 SCRA 552), cited by the respondent, does not support her ruling denying Philex's protest. In the case of Fernandez (supra.), the petitioner therein was to be compensated for its advances. The advances were in the nature of an investment. Thus, the petitioner in the Fernandez case cannot write off as bad debt the amount which he failed to realize from his advances or investment. In this case, the advances of Philex were not in the nature of an investment., rather in the nature of a loan which Philex expects to be repaid. Thus, Philex executed with Baguio Gold the Compromise and the Amendment. Moreover, the compensation referred to by the respondent does not pertain to Philex's compensation for its advances. Rather, it refers to Philex's compensation for the management of the Sto. Niño Mine.

On the other hand, respondent avers, by way of special and affirmative defenses that petitioner has no cause of action; that it has the burden of proof to show that there was a valid and subsisting debt as between the parties; and that, the failure to do so is fatal to its action.

Records reveal that it is only the petitioner that submitted its formal offer of evidence and memorandum. Respondent was considered to have waived her presentation of evidence in view of the repeated non-appearance of her counsel during the hearings of herein case. Likewise, respondent failed to file her memorandum within the time given by this Court.

The issues confronting this Court are the following, namely:

> 1. Whether or not petitioner has a valid and existing indebtedness with Baguio Gold; and,
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> 2. Whether or not the alleged indebtedness of Baguio Gold to the petitioner has been ascertained to be worthless.

After a painstaking scrutiny of the attending facts, the disquisition of the parties and the laws and jurisprudence applicable at bar, this Court rules in favor of the respondent.

At the outset, let it be understood that this Court is giving more emphasis and probative weight on the Power of Attorney executed by and between petitioner and Baguio Gold (Exhibit A) than the Compromise with Dation in Payment and its Amendment (Exhibits B and C) in the determination of the first issue. The reason being that the Power of Attorney is really the root basis of the "advances" given by the petitioner which it alleges to be loans or debts while the Compromise and its Amendment are just a product or consequence of the alleged non-payment of such loans or debts. In other words, the Power of

Attorney is the document containing the terms and agreements constituting the law between the parties.

We have to unravel the contents of the Power of Attorney before we could finally conclude that the advances of the petitioner is indeed a loan or debt, or as contended by the respondent, advances in the nature of an investment.

A reading of the Power of Attorney reveals the following excerpts which we find crucial in solving herein issue, to wit:

POWER OF ATTORNEY

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4. Within three (3) years from date hereof, the PRINCIPAL shall make available to the MANAGERS up to ELEVEN MILLION (₱11,000,000.00), in such amounts as from time to time may be required by the MANAGERS within the said 3 year period, for use in the management of the STO. NIÑO MINE. The said ELEVEN MILLION PESOS (₱11,000,000.00) shall be deemed, for internal audit purposes, as the owner's account in the Sto. Niño PROJECT. Any part of any income of the PRINCIPAL from the STO. NIÑO MINE, which is left with the Sto. Niño PROJECT, shall be added to such owner's account.

5. Whenever the MANAGERS shall deem it necessary and convenient in connection with the MANAGEMENT of the STO. NIÑO MINE, they may transfer their own funds or property to the STO. NIÑO PROJECT, in accordance with the following arrangements:

(a) The properties shall be appraised and, together with the cash, shall be carried by the Sto. Niño PROJECT as a special fund to be known as the MANAGER'S account.

(b) The total of the MANAGER'S account shall not exceed ₱11,000,000.00 except with the prior approval of the PRINCIPAL; provided, however, that if the compensation of the MANAGERS as herein provided cannot be paid in cash from the Sto. Niño PROJECT, the amount not so paid in cash shall be added to the MANAGER'S account.

(c) The cash and property shall not thereafter be withdrawn from the Sto. Niño PROJECT until termination of this Agency.

(d) The MANAGERS' account shall not accrue interest. Since it is the desire of the PRINCIPAL to extend to the MANAGERS the benefit of the subsequent appreciation of property, upon a projected termination of this Agency, the ratio which the MANAGER's account has to the owner's account will be determined, and the corresponding proportion of the entire assets of the STO. NIÑO MINE, excluding the claims, shall be transferred to the MANAGERS, except that such transferred assets shall not include mine development, roads, buildings, and similar property which will be valueless, or of slight value, to the MANAGERS. The MANAGERS can, on the other hand, require at their option that property originally transferred by them to the Sto. Niño PROJECT be re-transferred to them. Until such assets are transferred to the MANAGERS, this Agency shall remain subsisting.

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12. The compensation of the MANAGER shall be fifty per cent (50%) of the net profit of the Sto. Niño PROJECT before income tax. It is understood that the MANAGERS shall pay income tax on their compensation, while the PRINCIPAL shall pay income tax on the net profit of the Sto. Niño PROJECT after deduction therefrom of the MANAGERS' compensation.

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> 16. The PRINCIPAL has current pecuniary obligations in favor of the MANAGERS and, in the future, may incur other obligations in favor of the MANAGERS. This Power of Attorney has been executed as security for the payment and satisfaction of all such obligations of the PRINCIPAL in favor of the MANAGERS and as a means to fulfill the same. <u>Therefore, this Agency shall be irrevocable while any obligation of the PRINCIPAL in favor of the MANAGERS is outstanding, inclusive of the MANAGERS' account</u>. After all obligations of the PRINCIPAL in favor of the MANAGERS have been paid and satisfied in full, this Agency shall be revocable by the PRINCIPAL upon 36-month notice to the MANAGERS. (Underscoring supplied)

A close perusal of the above provisions readily reveal to us some telltale signs of contribution to capital in a partnership agreement rather than a contract of loan or debt that has been entered into by Baguio Gold and herein petitioner.

A bona fide debt has been defined as one which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money. (Section 1166-1(c) of US Internal Revenue Code regulations) In deciding whether a relationship represents a bona fide debt, *a fact and circumstances approach* which examines the substantive nature of the relationship on a case to case basis is employed. (**Fisher vs. Comm.**, 54 TC 905(1970) and **Goldstein vs. Comm.**, TC Memo 1980-273)

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In the case of **Estate of Mixon vs. U.S.,** 464 F2d 394 (CA5, 1972), the courts examined the following factors in determining whether advances are contributions to capital or loans, to wit:

(1) what name was given to the certificate evidencing the alleged debt;

(2) was there a fixed maturity date for the alleged debt;

(3) what were to be the sources of the debtor's corporation repayment of the alleged loan;

(4) would the creditor have a right to enforce repayment of the alleged loan;

(5) did the individual taxpayer's control over the debtor corporation increase as a result of the advances;

(6) was the creditor subordinated to the general creditors of the debtor corporation;

(7) what was the intention of the parties to the alleged loan;

(8) was the debtor corporation insufficiently capitalized;

(9) were the advances made in proportion to the shareholder's interest in the alleged debtor corporation;

(10) if a true lender, was the creditor concerned with collecting interest on the advances;

(11) would the debtor corporation have been able to obtain loans from outside lending institutions;

(12) were the advances used to purchase capital assets; and

(13) did the debtor corporation fail to pay the alleged debt on the due date.

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Using the above criteria as a guide, it is quite clear that what petitioner and Baguio Gold entered into was a partnership agreement for the development of the Sto. Niño Mine. There was no real creditor-debtor relationship between them in view of the following observations, to wit:

First, the MANAGERS' account is not an item of obligation recognizable as "accounts payable" for Baguio Gold. Paragraph 5(d) of the Power of Attorney clearly states that upon a projected termination of the agency, "the ratio which the MANAGERS' account has to the owner's (PRINCIPAL) account will be determined, and the corresponding proportion of the entire assets of the STO. NIÑO MINE, excluding the claims, shall be transferred to the managers x x x". This, to our mind, is a mere distribution of assets and not in any manner requiring payment, an element essential in loan obligations.

Second, the fact that the advances cannot thereafter be withdrawn, except upon the termination of the agency, as stated in paragraph 5(c), is a categorical demonstration of the intent of the parties in entering into a partnership agreement and not a contract of loan. The latter is extinguished by payment while partnership is terminated by the withdrawal of any of the partners.

Third, it is unlikely that a business corporation would in its right mind lend hundreds of millions of pesos without interest; proper security or collaterals, i.e., realty or bonds; and most importantly, a specific deed evidencing the terms and conditions of such loan or loans. This is what happened in this case.

The statement that the Power of Attorney, under paragraph 16 thereof, "has been executed as security for the payment and satisfaction of all such obligations of the PRINCIPAL in favor of the MANAGERS and as a means to fulfill the same", fails to meet the requirements of a valid and substantial security. The Power of Attorney is a mere agency. It does not bare out the assets of Baguio Gold that are constituted as security. We have to remember that Baguio Gold's biggest assets are presumably its mineral claims. Yet, in the transfer of assets to the petitioner out of its MANAGERS' account, under paragraph 5(d), such claims are not included. As it is, thus, the Power of Attorney itself is a mere scrap of paper insofar as security is concerned.

Fourth, we note that the document evidencing the advances is denominated as Power of Attorney, which is more appropriately used in the grant of authority than in contract of loans.

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Fifth, there is no specific or fixed maturity date as to when the supposed various loans or debts become due and demandable.

Sixth, the sources from where Baguio Gold is to get its repayment for the alleged loans are unclear.

Lastly, both parties contributed an equal amount of ₱11,000,000.00 initially, with the succeeding advances given by the petitioner inclusive of the part of compensation not paid in cash, added to the MANAGERS' account without interest. Likewise, annual net profit sharing was pegged at 50% for each of them with the assets of the Sto. Niño Mine being shared, upon the termination of the agency, in accordance with the ratio of each other's contribution to the PRINCIPAL and MANAGERS' account, respectively. We believe that these factors are strong indication of an investment activity rather than a loan transaction. Both parties simply engaged in a common fund with net profits shared evenly.

It is worthwhile to note that under Article 1769 (4) of the Civil Code of the Philippines, the 50-50% sharing of the net profits in the Sto. Niño Mine Project is a *prima facie* evidence that petitioner is a partner of Baguio Gold , thus:

Article 1769

> (4) The receipt by a person of a share of the profits of a business is a *prima facie* evidence that he is a partner in the business, but no such inference shall be drawn if such profits received in payment:
>
> (a) As a debt by installments or otherwise;
>
> (b) As wages of an employee or rent to a landlord;
>
> (c) As an annuity to a widow or representative of a deceased partner;
>
> (d) As interest on a loan, though the amount of payment vary with the profits of the business;
>
> (e) As the consideration for the sale of a goodwill of a business or other property by installments or otherwise.

A reading of the above enumerated exemptions on the presumption of partnership readily shows that petitioner's sharing of net profits is not one among them. The sharing of profits as wages of an employee which is the nearest to petitioner's case is not even applicable because in the case at bar, petitioner is not an employee but a manager under the management contract.

Even if we assume for the sake of argument that what petitioner and Baguio Gold entered into were loan transactions, still this Court would be constrained to consider them as not proper for bad debt deduction.

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This is due to the fact that the basic test of the existence of a debtor-creditor relationship is whether the debtor is under an <u>unconditional</u> obligation to repay the creditor. (Mertens' Law of Federal Income Taxation, Section 30.04 citing Agarano vs. U.S., 110 F Supp 609 among a litany of cases) Such unconditional obligation to repay is the first important factor singled out of all the abovecited facts and circumstances having a bearing on the existence of a debt. [Ibid. citing American Cigar Co. vs. Comm. 66 F2d 425 (CCA2, 1933), etc.]

Applying the preceding criterion, We observe that Baguio Gold, the "PRINCIPAL" party, is not even under an <u>unconditional</u> obligation to repay the "MANAGERS", represented herein by the petitioner. We note that petitioner has the authority to fully dictate at whim the point in time at which the obligation to repay the advances should arise or become outstanding. By virtue of the Power of Attorney which is a management or operating contract, petitioner has been given a free hand in the running of the affairs of Baguio Gold. And necessarily included in it, is its authority to decide which obligations are to be paid at a given time. Petitioner, in effect, solely determines the date of maturity of the obligations. In this sense, thus, the Power of Attorney makes the repayment of the outstanding

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obligations inclusive of the advances conditional to petitioner's act of demanding payment.

As the records bear, no such act of demanding payment from the date the Power of Attorney was signed in 1971 up to the time of petitioner's withdrawal as manager on January 28, 1982, was ever requested from Baguio Gold. It is rather uncanny that petitioner did not ask for payment even if it already knew as early as December 31, 1981 that Baguio Gold was already in technical default of its dollar denominated loans. Verily, this observation strongly supports our conclusion of joint venture agreement rather than a loan transaction.

To prove the existence of the alleged debts, petitioner submitted in evidence Baguio Gold's annual report for 1981 and the financial statements for years ended 1982 and 1981 together with the corresponding auditor's report in order to support its allegation that said debts were indeed duly reported as such. We are not swayed by petitioner's attempt. They are mere collateral and extrinsic evidence. The intention of the parties and the factors constitutive of a debtor-creditor relationship, as above discussed, should be limited to the confines of the terms of the instrument (Power of Attorney) purported to represent the debt transaction.

When the terms of an agreement have been reduced to writing, it is considered as containing all the terms agreed upon and, there can be, between the parties and their successors in interest, no evidence of such terms of the written agreement other than the contents of the written agreement. (1st par. of Section 9, Rule 130, Revised Rules of Court)

As regards petitioner's assertion that as a guarantor, it was obligated to pay for the loan obligations of Baguio Gold, this Court sees otherwise.

A brief glance on the documents offered in evidence shows that petitioner did not act as a true guarantor when it paid the loan obligations of Baguio Gold amounting to U.S. $11,000,000.00. What it did was to "pre-pay" or pay in advance said loans in August and December of 1982 although much of the same were still not due and demandable from Baguio Gold, the principal debtor (Exhibits Q and Q-1). Such loans were to be paid under a 7-year term starting from 1982 up to 1989 (Exhibits P, Q-1 and R-1). Clearly, Baguio Gold has not yet defaulted on its obligations when petitioner pre-paid the loans. This is contrary to Article 2047 of the Civil Code where it is stated that a guarantor is called upon to fulfill the obligation of the principal debtor only in case the latter should fail to do so.

Earlier in the statement of facts, we have noted petitioner's allegation that Baguio Gold was in technical default of its U.S.$8,000,000.00 loan as of December 31, 1981, hence, it had to assume said loan as a guarantor. We find this allegation to be totally baseless and not in conformity with the evidence on record.

The Notice of Principal and/or Interest Due sent by Bank of America dated July 1, 1982 on Baguio Gold's U.S. $8,000,000.00 loan (Exhibit R) shows that the bank is only asking for the payment of the installment and interest due in the amount of U.S.$533,333.38 and U.S.$650,666.67, respectively. If it were true that Baguio Gold was in technical default as of December 31, 1981, then why did the bank not collect the entire amount of the principal loan on July 1, 1982?

Likewise, we note that in the Statement of Account issued by Citibank to Baguio Gold dated August 11, 1982 (Exhibit O), the payment of the remaining U.S.$3,000,000.00, out of the U.S.$11,000,000.00 loan alleged to have been assumed by the petitioner, shows a "pre-termination penalty" as having been imposed by Citibank. We can only view this as a clear case of advance payment initiated by the petitioner, for which a pre-termination penalty has been collected by the bank.

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In line with our earlier conclusion, therefore, We believe that the amount of loans pre-paid by the petitioner were mere advances - properly belonging to the MANAGERS' account, pursuant to the joint venture agreement. Hence, it is nothing but another kind of contribution to capital.

With the above pronouncements, We deem it moot and academic to dwell anymore into the merit of the second issue.

WHEREFORE, in view of the foregoing, the instant Petition for Review is hereby **DENIED** for lack of merit. The assessment in question, viz: **FAS-1-82-88-003067** for deficiency income tax in the amount of **P62,811,161.39** is hereby **AFFIRMED**.

ACCORDINGLY, petitioner Philex Mining Corporation is hereby **ORDERED** to **PAY** respondent Commissioner of Internal Revenue the amount of **P62,811,161.39**, plus, 20% delinquency interest due computed from February 10, 1995, which is the date after the 20-day grace period given by the respondent within which petitioner has to pay the deficiency amount (Letter of Denial of Protest, Annex F, Petition) up to actual date of payment.

SO ORDERED.

AMANCIO Q. SAGA
Associate Judge

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WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

RAMON O. DE VEYRA
Associate Judge

CERTIFICATION

I hereby certify that the above 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