REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

DELFIN MA. V. CRUZ, JR.,
Petitioner,

- versus - C.T.A. CASE NO. 3806

COMMISSIONER OF INTERNAL REVENUE,
Respondent.
x - - - - - - - - - - - - x

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D E C I S I O N

This case involves the deductibility of interest payments for income tax purposes.

Petitioner declared for his 1974 income tax return the amount of P168,884.33 as deductible interest expense which the respondent Commissioner disallowed. Accordingly, a deficiency income tax assessment for the amount of P113,178.25 was issued under Demand Letter and Assessment Notice No. 26-3-06105591-74 dated December 14, 1979 (Exhs. "4" and "4-a").

Subsequently, petitioner's deficiency assessment was revised with a reduced income tax liability of P96,193.64, inclusive of interest (Exhs. "5", "6" and "7"), consequenced by the disallowance of an interest payment of P145,004.19 to a certain Pablo S. Cruz.

A request for further reconsideration under a January 22, 1980 letter (Exh. "C") of the revised assessment proved to no avail as the respondent sustained the correctness thereof under letters dated December 16, 1981 and January 25, 1982 (p. 84 and p. 92, BIR rec., respectively) but receipt thereof was denied by the petitioner.

On October 15, 1982, respondent filed a judicial action for collection in the Regional Trial Court of Quezon City, docketed as Civil Case No. Q-36492, entitled "Republic of the Philippines vs. Delfin Ma. V. Cruz, Jr." (Exh. "D"). Petitioner was duly served with summons with a copy of the said complaint on June 5, 1984.

Petitioner considered the filing of the judicial action a denial of his requested reconsideration of January 22, 1982, filed the instant petition for review on July 4, 1984.

The record raises the questions of jurisdiction and deductibility of interest payments for income tax purposes.

Respondent interposes as special and affirmative defense the lack of jurisdiction as the present petition filed on July 4, 1984 is beyond the reglementary 30-day period to appeal from respondent's decision. This Court, nevertheless finds, "There is no evidence to prove that the alleged letter of August 5, 1981, which would deny the motion for reconsideration of petitioner of January 22, 1980, has actually been sent to and received by the petitioner. What appears from the petition for review and its annexes (pp. 1 to 10, CTA rec.) as well as comment of petitioner (pp. 30-32, CTA rec.) is that, after filing its request for reconsideration of the assessment of December 14, 1979, petitioner received on June 5, 1984 summons and copies of respondent's complaint in Civil Case No. Q-36492, filed before the Regional Trial Court of Quezon City, Branch CIV, seeking to collect from petitioner the deficiency income tax of P96,193.64 as demanded under said assessment (No. 26-3-06105591-74) dated December 14, 1979. Verily, said complaint (or action) for collection filed before the Regional Trial Court of Quezon City tantamounts to a denial of petitioner's request for reconsideration of January 22, 1980 (See Republic v. Lim Tian Teng Sons and Co., Inc., L-21731, March 31, 1966, 16 SCRA 584; Santos v. Comm. of Int. Rev., CTA Case No. 3070, Aug. 14, 1981; Yabes v. Flojo, 115 SCRA 278) and the same was, from receipt of summons and copies thereof on June 5, 1984, timely appealed to this Court by petitioner on July

4, 1984 (See p. 1, CTA rec.). Indeed, the alleged letter of August 5, 1981 could not be treated as an appealable decision because, as petitioner bluntly denies having recevied the same, there is no proof of service thereof whether by mail or personal delivery." (Resolution, CTA Case No. 3806, August 11, 1987)

The remaining question is whether interest payment as allowable deduction for income tax purposes must necessarily be stipulated in writing.

Petitioner presents none of any such written stipulation much less the loan contract itself, but submits (1) a copy of the certification of Pablo S. Cruz dated September 12, 1978, certifying that he received from petitioner as payment of interest in 1974 in the amount of P145,004.19 (Exh. "F" BIR records, page 105); and (2) a copy of the income tax return of said Mr. Pablo S. Cruz for taxable year 1974 which declared receipt of interest income in 1974 in the amount of P145,004.19 from petitioner (Exh. "G"), thus, inferring that, 1) an indebtedness existed; 2) an obligation to pay interest on said indebtedness; and 3) interest was paid; and pressing the validity of the question, where there is no written contract of loan, may not collateral evidences to prove an existence of loan be admissible, like Exhibits "F" and "G"?

Respondent wraps up his unvarying assertion as thus:

> "Perforce, the certification issued by Pablo S. Cruz and the latter's Income Tax Return for 1974 (Exhs. "F" and "G", respectively, Petitioner) submitted in evidence in this case by petitioner do not suffice and cannot be a substitute for a written contract the terms which must stipulate the interest payable by petitioner to Pablo S. Cruz who in turn is under obligation to declare the same in his income tax return and pay the corresponding income tax due thereon. Moreover, petitioner should have withheld the corresponding income tax due on said P145,614.19 of P156,821.66 paid by his creditors. It is also worthy to note that Pablo S. Cruz is petitioner's co-borrower in a loan of P600,000.00 from Congeneric Development and Finance Corporation (p. 31, BIR records)."
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> "In view of the foregoing, it is very clear that petitioner's claim for deduction of the interest payment in the amount of P145,004.19 has no legal basis. Accordingly, the deficiency income tax assessment for 1974 issued against the petitioner was valid and in accordance with law."

We agree with the respondent Commissioner.

Section 30(b) of the National Internal Revenue Code of 1977 provides, in part, that there shall be allowed as deductions "interest paid or accrued within a taxable year on indebtedness incurred in connection with the taxpayer's profession, trade or business". The provision constitutes virtually the entire statutory framework for the deduction of interest payment for income tax purposes. Defined, interest is the amount one has contracted to pay for the use of borrowed money and as the compensation paid for the use or forbearance of money. (Old Colony Railroad Co., v. Commissioner, 284 U.S. 552 (1932) Ct. D. 456 C.B. XI-1, 274 (1932); Deputy v. Du Pont, 308 U.S. 488 (1940) Ct. D. 1435 C.B., 1940-1, 118.) Construed, the payment or accrual of interest for tax purposes must be incidental to an unconditional and legally enforceable obligation of the taxpayer claiming the deduction. (Paul Autenreith v. Commissioner, 115 F. 2d, 856 (1940), Fundamentals of Federal Income Taxation, 5th ed. 504 (1985.) The Civil Code provides, "No interest shall be due unless it has expressly stipulated in writing" (Art. 1956) and "All other contracts where the amount involved exceeds five hundred pesos must appear in writing even a private one." (Art. 1358)

So it appears that the sprouting impression precipitately broached by the petitioner that the certification of a creditor is within the legal contemplation can hardly be a reassuring prospect that can easily be infused valid cognizance.

Interest cannot be naively viewed as of such broad scope and spectrum with open ended features as would sire every payment the petitioner may expediently proffer to deduct. The provision as defined and construed explicitly states and clearly establishes the metes and bounds of the allowable interest which is an unconditional and legally enforceable obligation of the taxpayer. As thus qualified 1) there must be an indebtedness incurred in connection with the taxpayer's trade or business; 2) the interest must have been paid or accrued within the taxable year; and 3) the interest must be stipulated in writing. Hence, interest paid but not stipulated in writing is not deductible.

To require less would sanction an expedient arrangement unsustainable either by operation of law or applicable settled principles. These proscriptions of securing the integrity of the collection of lawful dues are no mere ingenuous sophistries conjured out of the same quirky insights but are tinged with strong issues of public policy to prevent fraud upon the revenue lest the cornerstone of effective collection be placed in the quicksand of self-interest. (Samwha Corporation, Ltd., v. Commissioner of Customs, CTA

Case No. 3099, July 31, 1981.) We are less impressed by what petitioner alleges than what he failed compliance.

WHEREFORE, petition is hereby dismissed at petitioner's costs.

SO ORDERED.

Quezon City, Metro Manila, June 29, 1990.

ALEX Z. REYES
Associate Judge

WE CONCUR:

AMANTE FILLER
Presiding Judge

CONSTANTE C. ROAQUIN
Associate Judge

CERTIFICATION

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

AMANTE FILLER
Presiding Judge
Court of Tax Appeals