REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

ESSO STANDARD EASTERN, INC.,
Petitioner, Nov. 11, 1968

versus CTA CASE NO. 1530

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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D E C I S I O N

Petitioner claims from respondent the refund of ₱184,162.32 as overpaid income tax for 1958 (par. 4, Petition for Review). On September 9, 1964, upon failure of respondent to act on said claim dated July 14, 1964, petitioner filed with this Court the present action under the provisions of Section 306 of the National Internal Revenue Code, in relation to Section 309 of the same Code.

Petitioner, a foreign corporation engaged in business in the Philippines, sold locally petroleum products in 1958. On April 15, 1959, petitioner filed its 1958 income tax return wherein it deducted from its gross income, among others, bad debts amounting to ₱160,202.81, itemized as follows:

1.	Antonio Palma	₱ 6,461.17
2.	J. V. Cruz	2,400.00
3.	Lopez-Ledesma Transp. Co. (Panay Autobus Co.)	58,917.32
4.	Sy Kee	27,541.00
5.	Central Azucarera de Danao	23,982.61
6.	Agusan Trading & Supply	15,008.90
7.	Philippine Milling Co.	10,696.77
8.	Antonio Tad-y	7,622.28
9.	Benigno Magno, Jr.	3,996.52
10.	Alfredo Tad-y	3,576.24
	TOTAL BAD DEBTS CLAIMED	₱160,202.81

On December 20, 1961, after an investigation, Special Investigator Fernando S. Acero and Senior Revenue Examiner Jose M. Alvarez reported and recommended to respondent the disallowance as deductions from gross income of (a) the exploration costs and expenses of ₱2,662,601.23 and (b) bad debts of ₱160,202.81 (Exh. 2, pp. 41-45, BIR rec.).

On July 18, 1962, based on the examiners' report and recommendation, respondent issued against petitioner a 1958 deficiency income tax assessment of ₱913,230.32, computed as follows:

Net income per return		₱16,337,025.57
Add: Unallowable deductions:		
(1) Exploration costs & expenses claimed as ordinary expenses	₱2,662,601.25	
Less: Amount deductible under the dry hole abandoned basis - abandoned acreage.	58,789.04	
Disallowance . . .	₱2,603,812.21	
(2) Bad debts disallowed	160,202.81	2,764,015.02
Net income per investigation.		₱19,101,040.59

Tax due thereon	₱ 5,340,291.00
Less: Amount already assessed	4,566,367.00
Balance	₱ 773,924.00
Add: ½% monthly interest from 6-20-59 to 6-20-62. . .	139,306.32
Deficiency tax due & collectible.	₱ 913,230.32

(Annex A, Petition for Review; pp. 50-51, BIR rec.)

On September 10, 1962, petitioner remitted and paid to respondent under Revenue Official Receipt No. C-294900, dated September 10, 1962 the said deficiency income tax of ₱913,230.32, inclusive of the ½% monthly interest from June 20, 1959 to June 20, 1962 (p. 60, BIR rec.).

Petitioner concedes that the exploration costs and expenses of ₱2,662,601.23 are not deductible from its gross income in 1958. Consequently, petitioner's claim for refund is limited to ₱184,162.38 representing income tax allegedly overpaid with respect to the disallowed deductions of bad debts from gross income and the deficiency interest of ½% a month.

The issues, therefore, submitted to the Court for resolution are the following:

1. Whether or not the bad debts claimed by petitioner are deductible from its 1958 gross income; and

2. Whether or not the imposition of ½% monthly interest on the basic deficiency income tax is legal and justifiable.

First Issue -

Petitioner desisted from contesting the disallowance of the deduction from gross income of the indebtedness of Messrs. Antonio Palma and J. V. Cruz in the amounts of ₱6,461.17 and ₱2,400.00, or a total of ₱8,861.17 (pp. 2-3, t.s.n.; Memo. for Petitioner, pp. 177, 180, CTA rec.). Consequently, we will only consider the following disputed items, namely:

Lopez-Ledesma (Panay Autobus Co.) account of ₱58,917.32:

Petitioner repeatedly demanded from the debtor payment of its indebtedness but it failed and defaulted in the payment of its obligation. On August 7, 1958, petitioner and other corporations instituted an action in the Court of First Instance of Iloilo to declare the debtor an insolvent and the said Court issued an order dated August 30, 1958, declaring the insolvency of said debtor (Exh. D-1).

The total obligation of the debtor to its various creditors amounted to ₱913,496.40 (Exhs. K-1 & K-3, pp. 143-144, CTA rec.) while the assets of the said insolvent debtor in the custody of the assignee, as of September 15, 1964, amounted to only ₱19,364.04. The staggering disparity between the assets of the insolvent debtor and the obligation to its creditors is ample justification for petitioner to consider the amount of ₱58,917.32 as bad debt in 1958 because it was ascertained to be worthless in that year. Moreover, we will not require the petitioner herein to be an incorrigible optimist and continue in a useless and time-consuming litigation before allowing the deduction of a bad debt from its gross income. Once it is established that the probability of recovery of a debt from one who failed to pay thirty reputable creditors is remote, the deductibility of said bad debt from gross income of the taxpayer is valid and justified (Pantex Oil Corp., Sec. 49,290 PH Memo TC; U. S. v. White Dental Mfg. Co., 71 L Ed 1121, 274 U.S. 398). The deduction, therefore, of ₱58,917.32 as a bad debt from petitioner's gross income in 1958 is supported by the evidence and justified under Section 30(e) (1) of the National Internal Revenue Code.

Sy Kee's account
of ₱27,541.00:

The debtor owes petitioner the sum of ₱27,541.00 as a result of purchases of kerosene products at wholesale price on a 30-day credit basis under the Reseller Sales Agreement (Exh. C, pp. 61 & 63, CTA rec.). To settle the said account, Sy Kee endorsed various checks drawn against the Equitable Banking Corporation but the same were dishonored by the said bank (Exh. C, pp. 61, 64-66, CTA rec.). Petitioner, therefore, demanded upon Sy Kee the replacement of the dishonored checks or the settlement of his account but to no avail. Consequently, petitioner instituted an action in the Court of First Instance of Manila against the debtor in 1958. In 1959, while the case was pending in court, Pioneer Insurance & Surety Company paid ₱5,000.00 to petitioner in accordance with the Reseller Sales Agreement. On April 20, 1961, the case was finally decided by the court against the debtor. Thereafter, an investigation was conducted by Mrs. Remedios Samson, attorney of petitioner, who could not locate either Sy Kee and his co-debtors or any property in their names (pp. 76-77, t.s.n.).

In the absence of any property of the debtor against which the judgment can be executed, the debt became worthless in the year of judgment and failure to execute. (Meurer Steel Barrel Co., Inc. v. Comm., 7 BTA 64-66.) In other words, the debt in question became worthless in 1961 when the judgment of the court was rendered and not in 1958 when the judicial action for the collection of the debt was instituted. Consequently, the debt of Sy Kee in the amount of ₱27,541.00 is not deductible from petitioner's gross income in 1958.)

<u>Central Azucarera del Danao's account of ₱23,982.61:</u>

The said entity owes petitioner the amount of ₱23,982.61 for petroleum products purchased and used in its sugar central. At the time of the transaction, the debtor is already indebted to the Philippine National Bank (PNB for short), but the obligation is secured by a mortgage of the debtor's properties. When the debtor defaulted in the payment of its obligation, PNB instituted foreclosure proceedings against the debtor's properties on August 28, 1958 in the Court of First Instance of Negros Occidental (Exh. F, pp. 85-89, CTA rec.). On September 6, 1958, the debtor's properties were placed under the possession, control and operation of the PNB. Upon investigation conducted by the credit department of petitioner in 1958, it was ascertained that "the liabilities of the debtor (Central Azucarera del Danao) far exceeds the assets" (p. 22, t.s.n.). Considering that the claim of PNB amounted to ₱5,690,388.84, exclusive of interests and attorneys fees, petitioner desisted from bringing a court action against the debtor to collect its credit. Consequently, petitioner wrote off in its books of account the said obligation as a worthless debt in 1958 (p. 22, t.s.n.).

In 1962, however, PNB purportedly paid ₱22,000.00 to the petitioner on account of the obligation of the debtor. The payment was erroneously made to Mobiloil (Phil.) Inc. The said payment is the subject of a court litigation between the two oil companies.

(Accordingly, we hold that said debt of ₱23,-982.61 was worthless in 1958 and should be allowed as a deduction from petitioner's gross income in that year. In the event that petitioner should recover the sum of ₱22,000.00 from Mobiloil (Phil.) Inc., the same shall be considered taxable income in the year of recovery. (See sec. 102, Rev. Regs. No. 2.))

<u>Agusan Trading and Supply's account of ₱15,008.90:</u>

Petitioner sold to Agusan Trading & Supply Company an "International Engine UD-14". The latter became indebted to the former in the amount of ₱15,008.90. Upon failure to pay the said account, petitioner filed an action for collection against the debtor in the Court of First Instance of Cebu. Subsequently, the court issued a writ of attachment against the properties of the debtor in Agusan but the said writ was returned by the Provincial

Sheriff of Agusan on September 4, 1958 with the statement that no properties of the debtor could be found inasmuch as the debtor company was dissolved in 1954 (Exhs. E, E-1, E-2, pp. 82-84, CTA rec.).

(Accordingly, we hold that the debt of ₱15,-008.90 was worthless in 1958 and should be deducted from petitioner's gross income in that year because the debtor had no visible properties which could be judicially attached to satisfy its obligation)(Meurer Steel Barrel Co., Inc. v. Comm., 7 BTA 64-66).

<u>Philippine Milling Company's account of ₱10,696.77:</u>

The Philippine Milling Co. had an outstanding account of ₱10,696.77 with petitioner in 1958. It was also indebted to the Development Bank of the Philippines (DBP for short), which indebtedness amounted to ₱5,048,471.23 as of December 22, 1958. The DBP account of the debtor was secured by a mortgage. Because of the inability of the debtor to settle its long outstanding account, DBP resorted to extrajudicial foreclosure of the mortgaged properties and the same were sold in 1958 to satisfy the debtor's obligation (Exh. G, pp. 109-110, CTA rec.). Despite representations made by petitioner, DBP was not disposed to pay petitioner the debtor's account of ₱10,696.77 (pp. 87-88, t.s.n.). Moreover, petitioner found that the assets of the debtor were "insignificant compared to its liabilities" and, therefore, "no legal action was taken to collect the account" (p. 25, t.s.n.).

Undoubtedly, the debt in question has lost its intrinsic or potential value in 1958. The sale of the debtor's properties in a foreclosure proceeding, leaving nothing to petitioner, is the identifiable event that established the worthlessness of the debt. Hence, petitioner lawfully and properly deducted the debt of ₱10,696.77 from its gross income in 1958.

<u>Antonio Tad-y's account of ₱7,622.28</u>:

The indebtedness of ₱7,622.28 was incurred by the debtor on account of purchases of oil and petroleum from petitioner. Upon failure of the debtor to pay said account, an action for collection was instituted by petitioner against the debtor in the Court of First Instance of Iloilo which rendered a favorable decision to petitioner on May 31, 1958 (Exh. J, p. 139, CTA rec.). On July 1, 1958, the said Court issued a writ of execution to enforce its judgment but the same was returned unsatisfied on July 17, 1958 because the debtor "has no money to pay the same and has no property subject to attachment" (Exh. J-1, p. 140, CTA rec.). Consequently, the debt of ₱7,622.28 should be allowed as a deduction from petitioner's gross income in 1958.

Benigno Magno Jr.'s account of ₱3,996.52:

The debtor took delivery on credit from petitioner of kerosene and oil products which amounted to ₱3,960.93 after partial payments. On August 3, 1957, after unsuccessful demands for payment, petitioner brought a suit to collect the amount of ₱3,960.93. On November 22, 1957, the court rendered a decision ordering the debtor to pay petitioner the amount of ₱3,883.84, plus interest. On February 17, 1959, a writ of execution was issued by the court but the Deputy Provincial Sheriff of Negros Occidental failed to take action thereon (Exhs. I-1, I-2, I-3 & I-4, pp. 134-138, CTA rec.). On June 30, 1960, an alias writ of execution was issued by the court but the same has not been returned by the officer concerned (Exh. I-4, p. 133, CTA rec.).

(The certainty that the debt in question is uncollectible depends upon the result of the writ of execution. Until then, this Court cannot ascertain whether the said debt is worthless.)

Consequently, the debt of Benigno Magno Jr. amounting to ₱3,996.52 which was deducted from petitioner's gross income in 1958 was properly disallowed by respondent.

Alfredo Tad-y's
account of ₱3,576.24:

Alfredo Tad-y is indebted to petitioner for purchases of oil and petroleum products from July, 1957 to October, 1957. Demands for payment were made by petitioner on the debtor, but the demands remained unheeded. Subsequently, an action to collect was instituted by petitioner against the debtor on May 23, 1958 in the Court of First Instance of Iloilo. On March 30, 1964, the said court sentenced the debtor to pay the petitioner the amount of ₱3,576.24, plus interest. This judgment was appealed by the debtor to the Court of Appeals (Exhs. H, H-1, pp. 124-130, CTA rec.).

(The mere institution of a judicial action for collection of a debt, despite the delayed decision of the court, is not determinative of the uncollectibility of the debt, particularly in this case where the judgment of the lower court is pending appeal before a superior court. Accordingly, we hold that the debt of ₱3,576.24 is not deductible from petitioner's gross income in 1958.)

The accounts, therefore, of Lopez-Ledesma Transp. Co., Central Azucarera del Danao, Agusan Trading & Supply, Philippine Milling Co. and Antonio Tad-y in the amounts of ₱58,917.32, ₱23,-982.61, ₱15,008.90, ₱10,696.77 and ₱7,622.28, respectively, or a total of ₱116,227.88, are deductible from petitioner's gross income in 1958. As the rate of corporate income tax due and collected thereon was 28%, petitioner is entitled to a refund of ₱32,543.80 as overpaid income tax for 1958, plus ₱5,857.88 as ½% monthly interest paid for a period of three (3) years, or a total of ₱38,401.68.

<u>Second Issue</u> -

In the resolution of the first issue, this Court held that petitioner is entitled to the refund of ₱5,857.88 as ½% monthly interest on bad debts of ₱116,227.88 which was allowed as deduction from petitioner's gross income for 1958. Deducting the said interest of ₱5,857.88 from the total interest of ₱139,306.32 assessed by respondent and paid by petitioner, it appears that the overpaid deficiency interest of ½% a month for three years would be ₱133,448.44.

The question at issue is whether or not the deficiency interest of ½% a month for a period of three years (18%) imposed by respondent on petitioner's 1958 taxable income is legal and justified under Section 51(d) of the National Internal Revenue Code in relation to Section 51(a) of the same Code, as amended by Republic Act No. 2343 which took effect on June 20, 1959.

The Supreme Court held in the case of Central Azucarera Don Pedro (G.R. No. L-23236, May 31, 1967) that respondent Commissioner of Internal Revenue can impose ½% monthly interest (6% per annum) on deficiency income tax due on income earned prior to the effectivity of Republic Act No. 2343 which took effect on June 20, 1959 (1958 and prior years) but assessed after said date provided that the ½% monthly interest on the deficiency income tax is imposed from the date of effectivity of said law but not exceeding a period of three (3) years, or a total of 18%.

WHEREFORE, respondent Commissioner of Internal Revenue is hereby ordered to refund to petitioner as overpaid deficiency income tax for 1958 and interest imposed thereon the total amount of ₱38,401.68. Without pronouncement as to costs.

SO ORDERED.

Quezon City, November 11, 1968.

ESTANISLAO R. ALVAREZ
Associate Judge

WE CONCUR:

ROMAN M. UMALI
Presiding Judge

RAMON L. AVANCEÑA
Associate Judge