REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

BACOLOD-MURCIA MILLING CO., INC.,
Petitioner,

versus

CTA CASE NO. 1402

Oct. 31/69

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

x - - - - - - - - - - - x

D E C I S I O N

This is an appeal from the decision of respondent holding petitioner liable for the sum of ₱1,685,068.25 as deficiency income tax and interest for the years 1957, 1958, 1959, 1960 and 1961.

Petitioner is a domestic corporation engaged in the manufacture of centrifugal sugar. For the years 1957 to 1961, petitioner reported its income and paid the corresponding tax on the fiscal year basis ending on September 30 of each year. After verification and investigation of the income tax returns and the books of accounts of petitioner, respondent, in a letter dated January 11, 1963, made a deficiency income tax assessment against the former in the amount of ₱1,403,057.94, inclusive of surcharge and interest, for the years 1957 to 1961. This assessment was disputed by petitioner in a letter dated February 8, 1963 and in another letter dated February 19, 1963. On May 22, 1963, the deficiency income tax for the years under review was increased to ₱1,685,068.25, itemized as follows:

35-ACR-80003-59/57

Net income per return	₱ 970,963.32
Add: Unallowable deductions:	
Bad Debts written off	670,336.36
Loss on material inventory	27,303.22
Excessive Depreciation - Rolling Stock and Portable Tracks	66,644.65
Net income per investigation	₱1,735,247.55
Tax due thereon	477,869.00
Less: Amount already paid	263,870.00
B a l a n c e	₱ 213,999.00
Add: 50% surcharge	106,999.50
½% monthly interest from June 20, 1959 to June 20, 1962	38,519.82
TOTAL AMOUNT DUE & COLLECTIBLE	₱ 359,518.32

35-ACR-800003-62/58

Net income per return	₱ 755,125.74
Add: Unallowable deductions:	
Bad Debts written off	334,841.65
Loss on Material Inventory	44,304.03
Excessive Depreciation - Rolling Stock and Portable Tracks	66,922.15
Loss on Fertilizer Venture	1,145.21
Net income per investigation	₱1,202,338.78
Tax due thereon	₱ 328,655.00
Less: Amount already paid	203,435.00
B a l a n c e	₱ 125,220.00
Add: 50% surcharge	62,610.00
½% monthly interest from June 20, 1959 to June 20, 1962	22,539.60
TOTAL AMOUNT DUE & COLLECTIBLE	₱ 210,369.60

1959

Net income per return	₱ 924,002.37
Add: Unallowable deductions & Addt'l. income:	
Bad Debts written off	416,867.00
Loss in Material Inventory	96,442.64
Fertilizer Sales Receivable Deducted Against Income	46,944.78
Share - Storage Income from Phil. Fiber Processing Company	24,667.50
Excess Depreciation - Rolling Stock and Portable Tracks	66,922.15
Loss on Fertilizer Venture	1,225.99
Net income per investigation	₱1,577,072.43
Tax due thereon	₱ 465,122.00
Less: Amount already paid	269,201.00
B a l a n c e	₱ 195,921.00
Add: 50% surcharge	97,960.50
½% monthly interest from Jan. 16, 1960 to Jan. 16, 1963	35,565.78
TOTAL AMOUNT DUE & COLLECTIBLE	₱ 329,447.28

1960

Net income per return	₱1,121,029.77
Add: Unallowable deductions:	
Bad debts written off	399.93
Loss on material inventory	5,817.55
Excess depreciation - Rolling stock & Portable tracks	66,713.93
Less: Profits in fertilizer venture	(778.86)
Net income per investigation	₱1,193,182.32
Tax due thereon	₱ 349,955.00
Less: Amount already assessed	328,309.00
B a l a n c e	₱ 21,646.00
Add: ½% monthly interest from Jan. 16, 1961 to May 22, 1963	3,055.71
TOTAL AMOUNT DUE & COLLECTIBLE	₱ 24,701.71

38-ACR-800056-62/61

Net income per return	₱3,776,045.63
Add: Unallowable deductions & addt'l. income:	
Bad debts written off	522,332.33
Loss on material inventory	217,679.13
Undeclared profits from shipment on "SS Culucundis"	797,718.57

Excess depreciation - Rolling stock & Portable tracks	₱ 66,713.93
Less: Profit - Fertilizer Venture	(74.85)
Net income per investigation	₱5,380,414.74
Tax due thereon	₱1,606,124.00
Less: Amount already assessed	1,124,814.00
B a l a n c e	₱ 481,310.00
Add: 50% surcharge	240,655.00
½% monthly interest from Jan. 16, 1962 to May 22, 1963	39,066.34
TOTAL AMOUNT DUE & COLLECTIBLE	₱ 761,031.34

(Exh. 7, pp. 365-369, BIR rec.)

The aforesaid deficiency assessment was brought about by the disallowance of certain deductions and failure to report certain incomes, hereinafter separately treated.

1. <u>Depreciation claim on rolling stock and portable tracks in the amount of ₱333,916.81 for all the years in question</u>.

Respondent disallowed 3% of the claimed 8% depreciation rate on the rolling stock and portable tracks on the ground that the Ma-ao Sugar Central Co., a sister corporation of petitioner located in the same vicinity and engaged in the same business, adopted the depreciation rate of 5% per annum. Respondent insists that the rate should be only 5% per annum, instead of the 8% consistently adopted by petitioner for the years under review. We have had an occasion to pass upon a similar question where this Court held:

> The fact that a company is depreciating similar assets at a lower rate does not mean that another company within the same vicinity should use the same rate. A taxpayer may adopt the rate of depreciation it deemed reasonable. While the burden of sustaining the deductions rests upon the taxpayer, such deductions must not be disallowed unless shown by clear and convincing evidence to be unreasonable (See Sec. 109, Rev. Reg. No. 2). Considering the use for which the assets in question were devoted and their estimated lifetime, we are convinced that the 8% rate of depreciation adopted by petitioner is reasonable. (Talisay-Silay Milling Co., Inc. v. Comm. of Int. Rev., CTA Cases Nos. 1399 & 1406, December 29, 1965.)

2. Losses of materials included in inventory.

Petitioner claimed deductions for losses of materials and supplies valued at ₱27,303.22 in 1957; ₱44,304.03 in 1958; ₱96,442.64 in 1959; ₱5,817.55 in 1960; and ₱217,679.13 in 1961. These amounts represent the differences between the book inventories and the actual count conducted at the end of the fiscal year. These discrepancies consist of unaccounted materials due to shrinkage, unrecorded issues by the property department, pilferages and certain materials which were considered obsolete. Respondent disallowed the deductions on the grounds that the examiners doubted the claim that the loss was due to pilferages, because of the tight security measures imposed in the taxpayer's offices and mill premises, and that in case of the obsolete materials, petitioner must dispose of the said materials before it could claim the value thereof as a loss.

We had also ruled on the deductibility of these items. In the previous cases of Talisay-Silay Milling Co., Inc. v. Comm. of Int. Rev., supra, and Ma-aO Sugar Central Co., Inc. v. Comm. of Int. Rev., CTA Case No. 1434, Sept. 21, 1967, this Court held:

> The losses arising from pilferages, shrinkage and wrong pricing are clearly deductible under Sec. 30(d)(2) of the Revenue Code. Similarly, the claimed deductions on materials and supplies, which were directly delivered to the various departments of petitioner without having been entered in the stock cards, are allowable as expenses under Sec. 30(a)(1) of the same Code since they form part of the cost of manufacturing.

3. Loss on fertilizer venture - (1958-1961).

With respect to the deduction of this item, petitioner conceded the correctness of the disallowance of the net amount of ₱1,517.49. (See p. 57, Petitioner's Memorandum, p. 118, CTA rec.)

4. Accounts receivable - ₱46,944.78 deducted in 1959.

This item was disallowed because petitioner allegedly failed to present proof as to who were the planters-debtors, as well as the time when the sale of fertilizer took place. However, it appears that the amount was written off and debited against

Reserve for Bad Debts in the journal voucher (Exh. 8, Petitioner's Envelope). Inasmuch as the accounts were properly determined to be worthless and actually written off in 1959, it should be allowed.

5. Bad Debts written off, to wit:

1957	₱ 670,336.36
1958	334,841.65
1959	416,867.00
1960	399.93
1961	522,332.33

The aforesaid amounts represent crop loans extended to petitioner's planters. While the amounts involved were not questioned, respondent maintains that the real creditor was the Philippine National Bank and not petitioner who was only a guarantor.

From the evidence on record it appears that the promissory notes were executed by the planters in favor of petitioner, the check vouchers were made by petitioner to the planters, and the subsidiary ledger sheets of each debtor were submitted to the Court. In other words, there is no privity between the planters and the Philippine National Bank.

In view of the evidence presented to the effect that said amounts were owing to petitioner and were ascertained to be worthless, the amounts were deductible in the year above mentioned, except the account of the late Congressman Lopez amounting to ₱51,000 which was written off at the end of the fiscal year September 30, 1958, as conceded by petitioner.

6. Share in storage income from Philippine Fiber Processing Company.

With respect to this item, petitioner conceded that it failed to take up the amount as income for the year 1959, but the amount to be considered should be ₱16,458.33 only and not ₱24,667.50.

7. Undeclared profits from shipment on "SS Calucundis" - ₱797,718.57.

In view of the decision of this Court in Talisay-Silay Milling Co., Inc. v. Comm. of Int. Rev., CTA Cases Nos. 1399 & 1406, supra, respondent conceded that the profits on said shipment accrued during the subsequent year. (See pp. 15-16, Memorandum for the Respondent, pp. 162-163, CTA rec.)

8. Fraud penalty - 50% surcharge.

The assessment in question carries with it the 50% fraud penalty for the fiscal years 1957, 1958, 1959 and 1961, in the amounts of ₱106,999.50, ₱62,-610.00, ₱97,960.50 and ₱240,655.00, respectively, or a total of ₱508,225.00.

In view of our opinion on the controversial items discussed above, we find no justification for the imposition of the 50% fraud penalty. We believe that petitioner has been candid in the preparation and filing of its returns and that the resulting controversy between the parties was due to an honest difference of opinion. The imposition of the above-mentioned fraud penalty is reversed for lack of basis. (See Ma-aO Sugar Central Co., Inc. v. Comm. of Int. Rev., CTA No. 1434, supra.)

WHEREFORE, the decision appealed from is hereby modified and petitioner is ordered to pay to the respondent or his representative the sum of ₱23,232.08 as deficiency income tax, including interest, computed as follows:

1957

None

1958

Net income per return		₱ 755,125.74
Add: Unallowable deductions:		
Bad debts written off-account of Congressman Pedro Lopez	₱ 51,000	
Loss on fertilizer venture	1,145.21	52,145.21
Net income per investigation		₱ 807,270.95
Tax due thereon		₱ 218,036.00
Less: Amount already paid		203,435.00
Balance		₱ 14,601.00
Add ½% monthly interest from June 20, 1959 to June 20, 1962		2,628.18
Total amount due & collectible		₱ 17,229.18

1959

Net income per return		₱ 924,002.37
Add: Unallowable deductions & addt'l. income -		
Share in storage income from Phil. Fiber Processing Co.	₱ 16,458.33	
Loss on fertilizer venture	1,225.99	17,684.32
Net income per investigation		₱ 941,686.69
Tax due thereon		₱ 274,506.00

Less: Amount already paid	₱ 269,201.00
Balance	₱ 5,305.00
Add: ½% monthly interest from Jan. 16, 1960 to Jan. 16, 1963	954.90
TOTAL AMOUNT DUE & COLLECTIBLE	₱ 6,259.90

1960

Net income per return	₱1,121,029.77
Deduct: Profit from fertilizer venture	778.86
Net income per investigation	₱1,120,250.91
Tax due thereon	₱ 328,075.00
Less: Amount already assessed	329,309.00
Amount overpaid	(₱ 234.00)

1961

Net income per return	₱3,776,045.63
Deduct: Profit from fertilizer venture	74.85
Net income per investigation	₱3,775,970.78
Tax due thereon	₱1,124,791.00
Less Amount already assessed	1,124,814.00
Amount overpaid	(₱ 23.00)

Summary

1957	None
1958	₱ 17,229.18
1959	6,259.90
1960	(234.00)
1961	(23.00)
Total	₱ 23,232.08

If the said sum of ₱23,232.08 is not paid in full within thirty (30) days from the date this decision becomes final and executory, petitioner shall, in addition, pay the delinquency penalties provided in Section 51(e) of the Revenue Code. Without pronouncement as to costs.

SO ORDERED.

Quezon City, October 31, 1969.

R M Umali
ROMAN M. UMALI
Presiding Judge

WE CONCUR:

Estanislao Alvarez
ESTANISLAO R. ALVAREZ
Associate Judge

Ramon L. Avanceña
RAMON L. AVANCEÑA
Associate Judge

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