Title: Philippine Refining Company vs. Court of Appeals, et al.

Facts:

The Philippine Refining Company (now known as "Unilever Philippines, Inc.") was assessed by the Commissioner of Internal Revenue to pay a deficiency tax for the year 1985 amounting to P1,892,584.00. This assessment was based on the disallowance of deductions claimed by the company for bad debts and interest expense. The company protested this assessment, claiming such disallowances were erroneous. Following the Commissioner's garnishment of the company's bank deposits, the company filed a petition for review with the Court of Tax Appeals (CTA), which modified the deficiency assessment but maintained the disallowance of certain bad debts. The company appealed to the Court of Appeals, which dismissed the petition, leading to the present appeal to the Supreme Court.

Issues:

1. Whether the Court of Appeals erred in affirming the CTA's decision to disallow the deduction of certain accounts as bad debts.
2. Whether the imposition of a 25% surcharge and 20% annual delinquency interest on the deficiency income tax liability was unwarranted.

Court's Decision:

The Supreme Court denied the petition, affirming the decision of the Court of Appeals.

1. Regarding the disallowance of bad debts, the Court held that the taxpayer must show that the debt is a valid subsisting debt, actually ascertained to be worthless and uncollectible within the taxable year, charged off within the taxable year, and that it arose from the taxpayer's trade or business. The Court found that the petitioner failed to prove the worthlessness of the debts with reasonable documentary evidence. Mere assertions by the company's financial accountant were deemed insufficient.

2. On the imposition of surcharges and interest due to the delay in tax payment, the Court upheld these as consistent with Sections 248 and 249 of the Tax Code. The penalties served to discourage delays in tax payment and were deemed compensatory rather than penal.

Doctrine:

This case reiterates the doctrine that for a debt to be considered "bad" and thereby deductible, the taxpayer must establish its worthlessness and uncollectibility within the taxable year through proper and sufficient evidence. Furthermore, it emphasizes the mandatory nature of surcharges and interest on delinquent tax payments as these are meant to compel timeliness and are compensatory for the use of government funds.

Class Notes:

– **Bad Debts Deduction:** For a debt to be deductible as a bad debt, it must be: (i) a valid and existing debt; (ii) ascertained to be worthless and uncollectible within the taxable year; (iii) charged off within the taxable year; (iv) arisen from the taxpayer's trade or business.
– **Surcharges and Interest for Delinquent Tax Payments:** Sections 248 and 249 of the Tax Code impose a 25% surcharge and 20% annual interest on delinquent tax payments, intended as a deterrent against delay in payment and to compensate the government for the delay.

Historical Background:

The case emphasizes the stringent measures the Philippine tax system employs to ensure that deductions claimed by taxpayers, especially large corporations, are valid and supported by sufficient evidence. It underscores the government's initiative to preempt revenue loss through unwarranted deductions and the importance of timely tax payments for the sustenance of governmental operations.