

COLLECTOR OF INTERNAL REVENUE, PETITIONER, VS. GOODRICH INTERNATIONAL RUBBER CO., RESPONDENT.

G.R. No. L-22265. December 22, 1967

Ponente: CONCEPCION, C.J.

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CONCEPCION, C.J.:

Appeal by the Government from a decision of the Court of Tax Appeals, setting aside the assessments made by the Commissioner of Internal Revenue, in the sums of P14,128.00 and P8,439.00, as deficiency income taxes alleged-ly due from respondent Goodrich International Rubber Company — hereinafter referred to as Goodrich — for the years 1951 and 1952, respectively.

These assessments were based on disallowed deductions, claimed by Goodrich, consisting of several alleged bad debts, in the aggregate sum of P50,455.41, for the year 1951, and the sum of P30,138.88, as representation expenses allegedly incurred in the year 1952. Goodrich had appealed from said as-sessments to the Court of Tax Appeals, which, after appropriate proceedings, rendered, on June 8, 1963, a decision allowing the deduction for bad debts, but disallowing the alleged representa-tion expenses. On motion for reconsideration and new trial, filed by Goodrich, on November 19, 1963, the Court of Tax Ap-peals amended its aforementioned decision and allowed said deductions for representation expenses. Hence, this appeal by the Government.

The alleged representation expenses are:

1. Expenses at Elks Club

P10,959.21

2. Manila Polo Club

4,947.35

3. Army and Navy Club

2,812.95

4. Manila Golf Club

4,478.45

5. Wack Wack Golf Club, Casino Español, etc..

6,940.92

T O T A L

P30,138.88

The claim for deduction thereof is based upon receipts issued, not by the entities in which the alleged expenses

had been incurred, but by the officers of Goodrich who allegedly paid them.

The claim must be rejected. If the expenses had real-ly been incurred, receipts or chits would have been issued by the entities to which the payments had been made, and it would have been easy for Goodrich or its officers to produce such re-ceipts. Those issued by said officers merely attest to their claim that they had incurred and paid said expenses. They do not establish payment of said alleged expenses to the entities in which the same are said to have been incurred. The Court of Tax Appeals erred, therefore, in allowing the deduction thereof.

The alleged bad debts are:

1. Portillo's Auto Seat Cover
P 630.31
2. Visayan Rapid Transit
17,810.26
3. Bataan Auto Seat Cover
373.13
4. Tres Amigos Auto Supply
1,370.31
5. P. C. Teodoro
650.00
6. Ordnance Service, P. A.
386.42
7. Ordnance Service, P. C
796.26
8. National Land Settlement Administration
3,020.76
9. National Coconut Corporation
644.74
10. Interior Caltex Service Station
1,505.87
11. San Juan Auto Supply
4,530.64
12. PACSA
45.36
13. Philippine Naval Patrol

14.18

14. Surplus Property Commission

277.68

15. Alvarez Auto Supply

285.62

16. Lion Shoe Store

11,686. 93

17. Ruiz Highway Transit

2,350.00

18. Esquire Auto Seat Cover

3,536.94

TOTAL

P 50,455.41

The issue, in connection with these debts, is whether or not the same had been properly deducted as bad debts for the year 1951. In this connection, we find:

Portillo's Auto Seat Cover (P730.00):

This debt was incurred in 1950. In 1951, the debtor paid P70.00, leaving a balance of P630.31. That same year, the account was written off as bad debt (Exhibit 3-C-4). Coun-sel for Goodrich had merely sent two (2) letters of demand in 1951 (Exh. B-14). In 1952, the debtor paid the full balance (Exhibit A).

Visayan Rapid Transit (P17,810.26):

This debt was, also, incurred in 1950. In 1951, it was charged off as bad debt, after the debtor had paid P275.21. No other payment had been made. Taxpayer's Accountant testified that, according to its branch manager in Cebu, he had been unable to collect the balance. The debtor had merely pro-mised and kept on promising to pay. Taxpayer's counsel stated that the debtor had gone out of business and became insolvent, but no proof to this effect was introduced.

Bataan Auto Seat Cover (P373.13):

This is the balance of a debt of P474.13 contracted in 1949. In 1951, the debtor paid P100.00. That same year, the balance of P373.13 was charged off as bad debt. The next year, the debtor paid the additional sum of P50.00.

Tres Amigos Auto Supply (P1,370.31):

This account had been outstanding since 1949. Counsel for the taxpayer had merely sent demand letters (Exh. B-13) without success.

P. C. Teodoro (P650.00):

In 1949, the account was P751.91. In 1951, the debtor paid P101.91, thus leaving a balance of P650.00, which the taxpayer charged off as bad debt in the same year. In 1952, the debtor made another payment of P160.00.

Ordinance Service, P. A. (P386.42):

In 1949, the outstanding account of this government agency was P817.55. Goodrich's counsel sent demand letters (Exh. B-8). In 1951, it paid Goodrich P431.13. The balance of P386.42 was written off as bad debt that same year.

Ordinance Service, P.C. (P796.26):

In 1950, the account was P796.26. It was referred to counsel for collection. In 1951, the account was written off as a bad debt. In 1952, the debtor paid it in full.

National Land Settlement Administration (P3,020.76):

The outstanding account in 1949 was P7,041.51. Collection letters were sent (Exh. B-7). In 1951, the debtor paid P4,020.75, leaving a balance of P3,020.76, which was written off, that same year, as a bad debt. This office was under liquidation, and its Board of Liquidators promised to pay when funds shall become available.

National Coconut Corporation (P644.74):

This account had been outstanding since 1949. Collection letters were sent (Exh. B-12) without success. It was written off as bad debt in 1951, while the corporation was under a Board of Liquidators, which promised to pay upon availability of funds. In 1961, the debt was fully paid.

Interior Caltex Service Station (P1,505.87):

The original account was P2,705.87, when, in 1950, it was turned over for collection to counsel for Goodrich (p. 156, CTA Records). Counsel began sending letters of collection in April 1950. Interior Caltex made partial payments, so that as of December, 1951, the balance outstanding was P1,505.87. The debtor paid P200, in 1952; P113.20, in 1954; P750.00, in 1961; and P300.00 in 1962. The account had been written off as bad debt in 1951.

The claim for deduction of these ten (10) debts should be rejected. Goodrich has not established either that the debts are actually worthless or that it had reasonable grounds to believe them to be so in 1951. Our statute permits the deduction of debts "actually ascertained to be worthless within the taxable year," obviously to prevent arbitrary action by the taxpayer, to unduly avoid tax liability.

The requirement of ascertainment of worthlessness requires proof of two facts: (1) that the taxpayer did in fact ascertain the debt to be worthless, in the year for which the deduction is sought; and (2) that, in so doing, he acted in good faith.[1]

Good faith on the part of the taxpayer is not enough. He must show, also, that he had reasonably investigated the relevant facts and had drawn a reasonable inference from the information thus obtained by him.[2] Respondent herein has not adequately made such showing.

The payments made, some in full, after some of the foregoing accounts had been characterized as bad debts, merely stresses the undue haste with which the same had been written off. At any rate, respondent has not proven that said debts were worthless. There is no evidence that the debtors can not pay them. It should be noted also that, in violation of Revenue Regulations No. 2, Section 102, respondent had not attached to its income tax returns a statement showing the propriety of the deductions therein made for alleged bad debts.

Upon the other hand, we find that the following accounts were properly written off:

San Juan Auto Supply (P4,530.64):

This account was contracted in 1950. Referred, for collection, to respondent's counsel, the latter secured no payment. In November, 1950, the corresponding suit for collection was filed (Exh. C). The debtor's counsel was

al-owed to withdraw, as such, the debtor having failed to meet him. In fact, the debtor did not appear at the hearing of the case. Judgment was rendered in 1951 for the creditor (Exh. C-2). The corresponding writ of execution (Exh. C-3) was returned unsatisfied, for no properties could be attached or levied upon.

PACSA (P45.36),

Philippine Naval Patrol (P14.18),

Surplus Property Commission (P277.68),

Alvarez Auto Supply (P285.62):

These four (4) accounts were 2 or 3 years old in 1951. After the collectors of the creditor had failed to collect the same, its counsel wrote letters of demand (Exhs. B-10, B-11, B-6 and B-2) to no avail. Considering the small amounts involved in these accounts, the taxpayer was justified in feeling that the un-successful efforts therefore exerted to collect the same sufficed to warrant their being written off.¹

Lion Shoe Store (P11,686.93),

Ruiz Highway Transit (P2,350.00), and

Esquire Auto Seat Cover (P3,536.94):

These three (3) accounts were among those referred to counsel for Goodrich for collection. Up to 1951, when they were written off, counsel had sent 17 letters of demand to Lion Shoe Store (Exh. B); 16 demand letters to Ruiz Highway Transit (Exh. B-1); and 6 letters of demand to Esquire Auto Seat Cover (Exh. B-5). In 1951, Lion Shoe Store, Ruiz Highway Transit, and Esquire Auto Seat Cover had made partial payments in the sums of P1,050.00, P400.00, and P300.00, respectively. Sub-sequent to the write-off, additional small payments were made and accounted for as income of Goodrich. Counsel interviewed the debtors, investigated their ability to pay and threatened law suits. He found that the debtors were in strained financial condition and had no attachable or leivable property. Moreover, Lion Shoe Store was burned twice, in 1948 and 1949. There-after, it continued to do business on limited scale. Later, it went out of business. Ruiz Highway Transit, had more debts than assets. Counsel, therefore, advised respondent to write off these accounts as bad debts without going to court, for it would be "foolish to spend good money after bad."

The deduction of these eight (8) accounts, aggregating P22,627.35, as bad debts should be allowed.

WHEREFORE, the decision appealed from should be, as it is hereby, modified, in the sense that respondent's alleged representation expenses are totally disallowed, and its claim for bad debts allowed up to the sum of P22,627.35 only. Without special pronouncement as to costs.

IT IS SO ORDERED.

Reyes, JBL, Dizon, Makalintal, Bengzon, Zaldivar, Sanchez, Ruiz Castro, Angeles, and Fernando, JJ., concur.

[1] T. H. Low, 19 BTA 980; Sec. 30.27, Mertens, Vol. 5, p. 392.

[2] Kahn v. Comm., 108 F (2d) 748 (CCA 2nd, 1940) aff'g 38 BTA 1417.

1 Richard Downing, et al, 43 BTA 1147, E. H. McConnel, 6 BTA 116; Fairmont Home Furniture Co., 23 BTA 909; The Great Northern Pacific Grocery Co., BTA Memo, Op., Cit. 87140, October 10, 1938; cited in Mertens, Vol. 5, pp. 418-419.

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