

**THE COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS.
CONSUELO L. VDA. DE PRIETO, RESPONDENT.***G.R. No. 13912. September 30, 1960*

Ponente: GUTIERREZ DAVID, J.

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This is an appeal from a decision of the Court of Tax Appeals reversing the decision of the Commissioner of Internal Revenue which held herein respondent Consuelo L. Vda. de Prieto liable for the payment of the sum of P21,410.38 as deficiency income tax, plus penalties and monthly interest.

The case was submitted for decision in the court below upon a stipulation of facts, which for brevity is summarized as follows: On December 4, 1945, the respondent conveyed by way of gifts to her four children, namely, Antonio, Benito, Carmen and Mauro, all surnamed Prieto, real property with a total assessed value of P892,497.50. After the filing of the gift tax returns on or about February 1, 1954, the petitioner Commissioner of Internal Revenue appraised the real property donated for gift tax purposes at P1,231,268.00, and assessed the total sum of P17,706.50 as donor's gift tax, interests and compromises due thereon. Of the total sum of P17,706.50 paid by respondent on April 29, 1954, the sum of P55,978.65 represents the total interest on account of delinquency. This sum of P55,978.65 was claimed as deduction, among others, by respondent in her 1954 income tax return. Petitioner, however, disallowed the claim and as a consequence of such disallowance assessed respondent for 1954 the total sum of P21,410.38 as deficiency income tax due on the aforesaid P55,978.65, including interest up to March 31, 1957, surcharge and compromise for the late payment.

Under the law, for interest to be deductible, it must be shown that there be an indebtedness, that there should be interest upon it, and that what is claimed as an interest deduction should have been paid or accrued within the year. It is here conceded that the interest paid by respondent was in consequence of the late payment of her donor's tax, and the same was paid within the year it is sought to be deducted. The only question to be determined, as stated by the parties, is whether or not such interest was paid upon an indebtedness within the contemplation of section 30 (b) (1) of the Tax Code, the pertinent part of which reads:

"SEC. 30. Deductions from gross income.—In computing net income there shall be allowed as deductions—

* * * * *

"(b) Interest:

"(1) In general.—The amount of interest paid within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations the interest upon which is exempt from taxation as income under this Title."

The term "indebtedness" as used in the Tax Code of the United States containing similar provisions as in the above-quoted section has been defined as an unconditional and legally enforceable obligation for the payment of money. (Federal Taxes Vol. 2, p. 13,019, Prentice-Hall, Inc.; Mertens' Law of Federal Income Taxation, Vol. 4, p.

542.) Within the meaning of that definition, it is apparent that a tax may be considered an indebtedness. As stated by this Court in the case of *Santiago Sambrano vs. Court of Tax Appeals and Collector of Internal Revenue* (101 Phil., 1; 53 Off. Gaz., 4839)—

"Although taxes already due have not, strictly speaking, the same concept as debts, they are, however, obligations that may be considered as such.

"The term "debt" is properly used in a comprehensive sense as embracing not merely money due by contract but whatever one is bound to render to another, either for contract, or the requirement of the law. (*Camben vs. Fink Coule & Coke Co.* 61 LRA 584).

"Where statute imposes a personal liability for a tax, the tax becomes, at least in a board sense, a debt. (*Idem*).

"A tax is a debt for which a creditor's bill may be brought in a proper case.' (*State vs. Georgia Co.*, 19 LRA 485)."

It follows that the interest paid by herein respondent for the late payment of her donor's tax is deductible from her gross income under section 30 (b) of the Tax Code above quoted.

The above conclusion finds support in the established jurisprudence in the United States after whose laws our Income Tax Law has been patterned. Thus, under sec. 23 (b) of the Internal Revenue Code of 1939, as amended[1], which contains similarly worded provisions as sec. 30 (b) of our Tax Code, the uniform ruling is that interest on taxes is interest on indebtedness and is deductible. (*U.S. vs. Jaffray*, 306 U.S. 276. See also *Lustig vs. U.S.*, 138 F. Supp. 870; *Commissioner of Internal Revenue vs. Bryer*, 151 F. 2d 267, 34 AFTR 151; *Penrose vs. U.S.* 18 F. Supp. 413, 18 AFTR 1289; *Max Thomas Davis, et al. vs. Commissioner of Internal Revenue*, 46, U.S. Board of Tax Appeals Reports, p. 663, citing *U.S. vs. Jaffray*, supra, *Smith vs. Commissioner of Internal Revenue*, 6 Tax Court of United States Reports, p. 255; *Armour vs. Commissioner of Internal Revenue*, 6 Tax Court of the United States Reports, p. 359; *The Koppers Coal Co. vs. Commissioner of Internal Revenue*, 7 Tax Court of United States Reports, p. 1209; *Toy vs. Commissioner of Internal Revenue*; *Lucas vs. Comm.*, 34 U.S. Board of Tax Appeals Reports. 877; *Evens & Howard Fire Brick Co. vs. Commissioner of Internal Revenue*, 8 U.S. Board of Tax Appeals Reports, 867; *Koppers Co. vs. Commissioner of Internal Revenue*, 3 Tax Court of United States Reports, p. 62). The rule applies even though the tax is nondeductible. (*Federal Taxes*, Vol. 2, Prentice Hall, sec. 163, 13,022; see also *Mertens' Law of Federal Income Taxation*, Vol. 5, pp. 23-24.)

To sustain the proposition that the interest payment in question is not deductible for the purpose of computing respondent's net income, petitioner relies heavily on section 80 of Revenue Regulation No. 2 (known as Income Tax Regulation) promulgated by the Department of Finance, which provides that "the word 'taxes' means taxes proper and no deductions should be allowed for amounts representing interest, surcharge, or penalties incident to delinquency." The court below, however, held section 80 as inapplicable to the instant case because while it implements sections 30 (c) of the Tax Code governing deduction of taxes, the respondent taxpayer seeks to come under section 30 (b) of the same Code providing for deduction of interest on indebtedness. We find the lower court's ruling to be correct. Contrary to petitioner's belief, the portion of section 80 of Revenue Regulation No. 2 under consideration has been part and parcel of the development to the law on deduction of taxes in the United States. (See *Capital Bldg. & Loan Assn. vs. Comm.*, 23 BTA 848. Thus, Mertens in his treatise says : "Penalties are to be distinguished from taxes and they are not deductible under the heading of taxes." * * * Interest on state taxes is not deductible as taxes." (Vol. 5, *Law on Federal Income Taxation*, pp. 22-23, sec. 27.06, citing cases.) This notwithstanding, courts in that jurisdiction, however, have invariably held that interest on deficiency taxes are deductible, not as taxes, but as interest. (*U.S. vs. Jaffray*, et al., supra; see also Mertens, sec. 26.09, Vol. 4, p. 552, and cases cited therein.) Section 80 of Revenue Regulation No. 2, therefore, merely incorporated the

established application of the tax deduction statute in the United States, where deduction of "taxes" has always been limited to taxes proper and has never included interest on delinquent taxes, penalties and surcharges.

To give to the quoted portion of section 80 of our Income Tax Regulations the meaning that the petitioner gives it would run counter to the provision of section 30 (b) of the Tax Code and the construction given to it by courts in the United States. Such effect would thus make the regulation invalid for a "regulation which operates to create a rule out of harmony with the statute, is a mere nullity." (Lynch vs. Tilden Produce Co., 265 U.S. 315; Miller vs. U.S., 294 U.S. 435.) As already stated, section 80 implements only section 30 (c) of the Tax Code, or the provision allowing deduction of taxes, while herein respondent seeks to be allowed deduction under section 30(b), which provides for deduction of interest on indebtedness.

In conclusion, we are of the opinion and so hold that although interest payment for delinquent taxes is not deductible as tax under Section 30 (c) of the Tax Code and section 80 of the Income Tax Regulations, the taxpayer is not precluded thereby from claiming said interest payment as deduction under section 30 (b) of the same Code.

In view of the foregoing, the decision sought to be reviewed is affirmed, without pronouncement as to costs.

Bengzon, Bautista Angelo, Labrador, Barrera, Paredes, and Dizon, JJ., concur.

Paras, C. J., Concepcion, and Reyes, J. B. L., JJ., concur in the result.

[1] Section 23 (b) of the Internal Revenue Code of 1939, as amended, provides:

"SEC. 23. Deductions from gross income. In computing net income there shall be allowed as deductions:

* * * * *

"(b) Interest. All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from the taxes imposed by this Chapter." (26 U.S.C.A. pp. 43-44.)

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