

THIRD DIVISION

[G.R. No. 148187, April 16, 2008]

**PHILEX MINING CORPORATION, Petitioner, vs. COMMISSIONER
OF INTERNAL REVENUE, Respondent.**

DECISION

YNARES-SATIAGO, J.:

This is a petition for review on certiorari of the June 30, 2000 Decision^[1] of the Court of Appeals in CA-G.R. SP No. 49385, which affirmed the Decision^[2] of the Court of Tax Appeals in C.T.A. Case No. 5200. Also assailed is the April 3, 2001 Resolution^[3] denying the motion for reconsideration.

The facts of the case are as follows:

On April 16, 1971, petitioner Philex Mining Corporation (Philex Mining), entered into an agreement^[4] with Baguio Gold Mining Company ("Baguio Gold") for the former to manage and operate the latter's mining claim, known as the Sto. Nino mine, located in Atok and Tublay, Benguet Province. The parties' agreement was denominated as "Power of Attorney" and provided for the following terms:

4. Within three (3) years from date thereof, the PRINCIPAL (Baguio Gold) shall make available to the MANAGERS (Philex Mining) up to ELEVEN MILLION PESOS (P11,000,000.00), in such amounts as from time to time may be required by the MANAGERS within the said 3-year period, for use in the MANAGEMENT of the STO. NINO MINE. The said ELEVEN MILLION PESOS (P11,000,000.00) shall be deemed, for internal audit purposes, as the owner's account in the Sto. Nino PROJECT. Any part of any income of the PRINCIPAL from the STO. NINO MINE, which is left with the Sto. Nino PROJECT, shall be added to such owner's account.

5. Whenever the MANAGERS shall deem it necessary and convenient in connection with the MANAGEMENT of the STO. NINO MINE, they may transfer their own funds or property to the Sto. Nino PROJECT, in accordance with the following arrangements:

(a) The properties shall be appraised and, together with the cash, shall be carried by the Sto. Nino PROJECT as a special fund to be known as the MANAGERS' account.

(b) The total of the MANAGERS' account shall not exceed P11,000,000.00, except with prior approval of the PRINCIPAL; provided, however, that if the compensation of the MANAGERS as herein provided cannot be paid in cash from the Sto. Nino PROJECT, the amount not so paid in cash shall be added to the MANAGERS'

account.

(c) The cash and property shall not thereafter be withdrawn from the Sto. Nino PROJECT until termination of this Agency.

(d) The MANAGERS' account shall not accrue interest. Since it is the desire of the PRINCIPAL to extend to the MANAGERS the benefit of subsequent appreciation of property, upon a projected termination of this Agency, the ratio which the MANAGERS' account has to the owner's account will be determined, and the corresponding proportion of the entire assets of the STO. NINO MINE, excluding the claims, shall be transferred to the MANAGERS, except that such transferred assets shall not include mine development, roads, buildings, and similar property which will be valueless, or of slight value, to the MANAGERS. The MANAGERS can, on the other hand, require at their option that property originally transferred by them to the Sto. Nino PROJECT be re-transferred to them. Until such assets are transferred to the MANAGERS, this Agency shall remain subsisting.

x x x x

12. The compensation of the MANAGER shall be fifty per cent (50%) of the net profit of the Sto. Nino PROJECT before income tax. It is understood that the MANAGERS shall pay income tax on their compensation, while the PRINCIPAL shall pay income tax on the net profit of the Sto. Nino PROJECT after deduction therefrom of the MANAGERS' compensation.

x x x x

16. The PRINCIPAL has current pecuniary obligation in favor of the MANAGERS and, in the future, may incur other obligations in favor of the MANAGERS. This Power of Attorney has been executed as security for the payment and satisfaction of all such obligations of the PRINCIPAL in favor of the MANAGERS and as a means to fulfill the same. Therefore, this Agency shall be irrevocable while any obligation of the PRINCIPAL in favor of the MANAGERS is outstanding, inclusive of the MANAGERS' account. After all obligations of the PRINCIPAL in favor of the MANAGERS have been paid and satisfied in full, this Agency shall be revocable by the PRINCIPAL upon 36-month notice to the MANAGERS.

17. Notwithstanding any agreement or understanding between the PRINCIPAL and the MANAGERS to the contrary, the MANAGERS may withdraw from this Agency by giving 6-month notice to the PRINCIPAL. The MANAGERS shall not in any manner be held liable to the PRINCIPAL by reason alone of such withdrawal. Paragraph 5(d) hereof shall be operative in case of the MANAGERS' withdrawal.

x x x x^[5]

In the course of managing and operating the project, Philex Mining made advances of cash and property in accordance with paragraph 5 of the agreement. However, the mine suffered continuing losses over the years which resulted to petitioner's withdrawal as manager of the mine on January 28, 1982 and in the eventual cessation of mine operations on February 20, 1982.^[6]

Thereafter, on September 27, 1982, the parties executed a "Compromise with Dation in Payment"^[7] wherein Baguio Gold admitted an indebtedness to petitioner in the amount of P179,394,000.00 and agreed to pay the same in three segments by first assigning Baguio Gold's tangible assets to petitioner, transferring to the latter Baguio Gold's equitable title in its Philodrill assets and finally settling the remaining liability through properties that Baguio Gold may acquire in the future.

On December 31, 1982, the parties executed an "Amendment to Compromise with Dation in Payment"^[8] where the parties determined that Baguio Gold's indebtedness to petitioner actually amounted to P259,137,245.00, which sum included liabilities of Baguio Gold to other creditors that petitioner had assumed as guarantor. These liabilities pertained to long-term loans amounting to US\$11,000,000.00 contracted by Baguio Gold from the Bank of America NT & SA and Citibank N.A. This time, Baguio Gold undertook to pay petitioner in two segments by first assigning its tangible assets for P127,838,051.00 and then transferring its equitable title in its Philodrill assets for P16,302,426.00. The parties then ascertained that Baguio Gold had a remaining outstanding indebtedness to petitioner in the amount of P114,996,768.00.

Subsequently, petitioner wrote off in its 1982 books of account the remaining outstanding indebtedness of Baguio Gold by charging P112,136,000.00 to allowances and reserves that were set up in 1981 and P2,860,768.00 to the 1982 operations.

In its 1982 annual income tax return, petitioner deducted from its gross income the amount of P112,136,000.00 as "loss on settlement of receivables from Baguio Gold against reserves and allowances."^[9] However, the Bureau of Internal Revenue (BIR) disallowed the amount as deduction for bad debt and assessed petitioner a deficiency income tax of P62,811,161.39.

Petitioner protested before the BIR arguing that the deduction must be allowed since all requisites for a bad debt deduction were satisfied, to wit: (a) there was a valid and existing debt; (b) the debt was ascertained to be worthless; and (c) it was charged off within the taxable year when it was determined to be worthless.

Petitioner emphasized that the debt arose out of a valid management contract it entered into with Baguio Gold. The bad debt deduction represented advances made by petitioner which, pursuant to the management contract, formed part of Baguio Gold's "pecuniary obligations" to petitioner. It also included payments made by petitioner as guarantor of Baguio Gold's long-term loans which legally entitled petitioner to be subrogated to the rights of the original creditor.

Petitioner also asserted that due to Baguio Gold's irreversible losses, it became evident that it would not be able to recover the advances and payments it had made in behalf of Baguio Gold. For a debt to be considered worthless, petitioner claimed

that it was neither required to institute a judicial action for collection against the debtor nor to sell or dispose of collateral assets in satisfaction of the debt. It is enough that a taxpayer exerted diligent efforts to enforce collection and exhausted all reasonable means to collect.

On October 28, 1994, the BIR denied petitioner's protest for lack of legal and factual basis. It held that the alleged debt was not ascertained to be worthless since Baguio Gold remained existing and had not filed a petition for bankruptcy; and that the deduction did not consist of a valid and subsisting debt considering that, under the management contract, petitioner was to be paid fifty percent (50%) of the project's net profit.^[10]

Petitioner appealed before the Court of Tax Appeals (CTA) which rendered judgment, as follows:

WHEREFORE, in view of the foregoing, the instant Petition for Review is hereby DENIED for lack of merit. The assessment in question, viz: FAS-1-82-88-003067 for deficiency income tax in the amount of P62,811,161.39 is hereby AFFIRMED.

ACCORDINGLY, petitioner Philex Mining Corporation is hereby ORDERED to PAY respondent Commissioner of Internal Revenue the amount of P62,811,161.39, plus, 20% delinquency interest due computed from February 10, 1995, which is the date after the 20-day grace period given by the respondent within which petitioner has to pay the deficiency amount x x x up to actual date of payment.

SO ORDERED.^[11]

The CTA rejected petitioner's assertion that the advances it made for the Sto. Nino mine were in the nature of a loan. It instead characterized the advances as petitioner's investment in a partnership with Baguio Gold for the development and exploitation of the Sto. Nino mine. The CTA held that the "Power of Attorney" executed by petitioner and Baguio Gold was actually a partnership agreement. Since the advanced amount partook of the nature of an investment, it could not be deducted as a bad debt from petitioner's gross income.

The CTA likewise held that the amount paid by petitioner for the long-term loan obligations of Baguio Gold could not be allowed as a bad debt deduction. At the time the payments were made, Baguio Gold was not in default since its loans were not yet due and demandable. What petitioner did was to pre-pay the loans as evidenced by the notice sent by Bank of America showing that it was merely demanding payment of the installment and interests due. Moreover, Citibank imposed and collected a "pre-termination penalty" for the pre-payment.

The Court of Appeals affirmed the decision of the CTA.^[12] Hence, upon denial of its motion for reconsideration,^[13] petitioner took this recourse under Rule 45 of the Rules of Court, alleging that:

I.

The Court of Appeals erred in construing that the advances made by

Philex in the management of the Sto. Nino Mine pursuant to the Power of Attorney partook of the nature of an investment rather than a loan.

II.

The Court of Appeals erred in ruling that the 50%-50% sharing in the net profits of the Sto. Nino Mine indicates that Philex is a partner of Baguio Gold in the development of the Sto. Nino Mine notwithstanding the clear absence of any intent on the part of Philex and Baguio Gold to form a partnership.

III.

The Court of Appeals erred in relying only on the Power of Attorney and in completely disregarding the Compromise Agreement and the Amended Compromise Agreement when it construed the nature of the advances made by Philex.

IV.

The Court of Appeals erred in refusing to delve upon the issue of the propriety of the bad debts write-off.^[14]

Petitioner insists that in determining the nature of its business relationship with Baguio Gold, we should not only rely on the "Power of Attorney", but also on the subsequent "Compromise with Dation in Payment" and "Amended Compromise with Dation in Payment" that the parties executed in 1982. These documents, allegedly evinced the parties' intent to treat the advances and payments as a loan and establish a creditor-debtor relationship between them.

The petition lacks merit.

The lower courts correctly held that the "Power of Attorney" is the instrument that is material in determining the true nature of the business relationship between petitioner and Baguio Gold. Before resort may be had to the two compromise agreements, the parties' contractual intent must first be discovered from the expressed language of the primary contract under which the parties' business relations were founded. It should be noted that the compromise agreements were mere collateral documents executed by the parties pursuant to the termination of their business relationship created under the "Power of Attorney". On the other hand, it is the latter which established the juridical relation of the parties and defined the parameters of their dealings with one another.

The execution of the two compromise agreements can hardly be considered as a subsequent or contemporaneous act that is reflective of the parties' true intent. The compromise agreements were executed eleven years after the "Power of Attorney" and merely laid out a plan or procedure by which petitioner could recover the advances and payments it made under the "Power of Attorney". The parties entered into the compromise agreements as a consequence of the dissolution of their business relationship. It did not define that relationship or indicate its real character.