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THIRD DIVISION

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

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

D E C I S I O N

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(c) The cash and property shall not thereafter be withdrawn from the Sto.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.
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> 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.

An examination of the "Power of Attorney" reveals that a partnership or joint venture was indeed intended by the parties. Under a contract of partnership, two or more persons bind themselves to contribute money, property, or industry to a common fund, with the intention of dividing the profits among themselves.[15] While a corporation, like petitioner, cannot generally enter into a contract of partnership unless authorized by law or its charter, it has been held that it may enter into a joint venture which is akin to a particular partnership:

> The legal concept of a joint venture is of common law origin. It has no precise legal definition, but it has been generally understood to mean an organization formed for some temporary purpose. x x x It is in fact hardly distinguishable from the partnership, since their elements are similar - community of interest in the business, sharing of profits and losses, and a mutual right of control. x x x The main distinction cited by most opinions in common law jurisdictions is that the partnership contemplates a general business with some degree of continuity, while the joint venture is formed for the execution of a single transaction, and is thus of a temporary nature. x x x This observation is not entirely accurate in this jurisdiction, since under the Civil Code, a partnership may be particular or universal, and a particular partnership may have for its object a specific undertaking. x x x It would seem therefore that under Philippine law, a joint

> venture is a form of partnership and should be governed by the law of partnerships. The Supreme Court has however recognized a distinction between these two business forms, and has held that although a corporation cannot enter into a partnership contract, it may however engage in a joint venture with others. x x x (Citations omitted) [16]

Perusal of the agreement denominated as the "Power of Attorney" indicates that the parties had intended to create a partnership and establish a common fund for the purpose. They also had a joint interest in the profits of the business as shown by a 50-50 sharing in the income of the mine.

Under the "Power of Attorney", petitioner and Baguio Gold undertook to contribute money, property and industry to the common fund known as the Sto. Niño mine.[17] In this regard, we note that there is a substantive equivalence in the respective contributions of the parties to the development and operation of the mine. Pursuant to paragraphs 4 and 5 of the agreement, petitioner and Baguio Gold were to contribute equally to the joint venture assets under their respective accounts. Baguio Gold would contribute **P11M** under its owner's account plus any of its **income** that is left in the project, in addition to its **actual mining claim**. Meanwhile, petitioner's contribution would consist of its **expertise** in the management and operation of mines, as well as the manager's account which is comprised of **P11M** in funds and property and petitioner's **"compensation"** as manager that cannot be paid in cash.

However, petitioner asserts that it could not have entered into a partnership agreement with Baguio Gold because it did not "bind" itself to contribute money or property to the project; that under paragraph 5 of the agreement, it was only optional for petitioner to transfer funds or property to the Sto. Niño project "(w)henever the MANAGERS shall deem it necessary and convenient in connection with the MANAGEMENT of the STO. NIÑO MINE."[18]

The wording of the parties' agreement as to petitioner's contribution to the common fund does not detract from the fact that petitioner transferred its funds and property to the project as specified in paragraph 5, thus rendering effective the other stipulations of the contract, particularly paragraph 5(c) which prohibits petitioner from withdrawing the advances until termination of the parties' business relations. As can be seen, petitioner became bound by its contributions once the transfers were made. The contributions acquired an obligatory nature as soon as petitioner had chosen to exercise its option under paragraph 5.

There is no merit to petitioner's claim that the prohibition in paragraph 5(c) against withdrawal of advances should not be taken as an indication that it had entered into a partnership with Baguio Gold; that the stipulation only showed that what the parties entered into was actually a contract of agency coupled with an interest which is not revocable at will and not a partnership.

In an agency coupled with interest, it is the **agency** that cannot be revoked or withdrawn **by the principal** due to an interest of a third party that depends upon it, or the mutual interest of both principal and agent.[19] In this case, the non-revocation or non-withdrawal under paragraph 5(c) applies to the **advances** made by petitioner who is supposedly the **agent** and not the principal under the contract. Thus, it cannot be inferred from the stipulation that the parties' relation under the agreement is one of agency coupled with an interest and not a partnership.

Neither can paragraph 16 of the agreement be taken as an indication that the relationship of the parties was one of agency and not a partnership. Although the said provision states that "this Agency shall be irrevocable while any obligation of the PRINCIPAL in favor of the MANAGERS is outstanding, inclusive of the MANAGERS' account," it does not necessarily follow that the parties entered into an agency contract coupled with an interest that cannot be withdrawn by Baguio Gold.

It should be stressed that the main object of the "Power of Attorney" was not to confer a power in favor of petitioner to contract with third persons on behalf of Baguio Gold but to create a business relationship between petitioner and Baguio Gold, in which the former was to manage and operate the latter's mine through the parties' mutual contribution of material resources and industry. The essence of an agency, even one that is coupled with interest, is the agent's ability to represent his principal and bring about business relations between the latter and third persons.[20] Where representation for and in behalf of the principal is merely incidental or necessary for the proper discharge of one's paramount undertaking under a contract, the latter may not necessarily be a contract of agency, but some other agreement depending on the ultimate undertaking of the parties.[21]

In this case, the totality of the circumstances and the stipulations in the parties' agreement indubitably lead to the conclusion that a partnership was formed between petitioner and Baguio Gold.

First, it does not appear that Baguio Gold was unconditionally obligated to return the advances made by petitioner under the agreement. Paragraph 5 (d) thereof provides that upon termination of the parties' business relations, "the ratio which the MANAGER'S 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 petitioner.[22] As pointed out by the Court of Tax Appeals, petitioner was merely entitled to a proportionate return of the mine's assets upon dissolution of the parties' business relations. There was nothing in the agreement that would require Baguio Gold to make payments of the advances to petitioner as would be recognized as an item of obligation or "accounts payable" for Baguio Gold.

Thus, the tax court correctly concluded that the agreement provided for a distribution of assets of the Sto. Niño mine upon termination, a provision that is more consistent with a partnership than a creditor-debtor relationship. It should be pointed out that in a contract of

loan, a person who receives a loan or money or any fungible thing acquires ownership thereof and is **bound** to pay the creditor an equal amount of the same kind and quality.[23] In this case, however, there was no stipulation for Baguio Gold to actually repay petitioner the cash and property that it had advanced, but only the return of an amount pegged at a ratio which the manager's account had to the owner's account.

In this connection, we find no contractual basis for the execution of the two compromise agreements in which Baguio Gold recognized a debt in favor of petitioner, which supposedly arose from the termination of their business relations over the Sto. Nino mine. The "Power of Attorney" clearly provides that petitioner would only be entitled to the return of a proportionate share of the mine assets to be computed at a ratio that the manager's account had to the owner's account. Except to provide a basis for claiming the advances as a bad debt deduction, there is no reason for Baguio Gold to hold itself liable to petitioner under the compromise agreements, for any amount over and above the proportion agreed upon in the "Power of Attorney".

Next, the tax court correctly observed that it was unlikely for a business corporation to lend hundreds of millions of pesos to another corporation with neither security, or collateral, nor a specific deed evidencing the terms and conditions of such loans. The parties also did not provide a specific maturity date for the advances to become due and demandable, and the manner of payment was unclear. All these point to the inevitable conclusion that the advances were not loans but capital contributions to a partnership.

The strongest indication that petitioner was a partner in the Sto Niño mine is the fact that it would receive 50% of the net profits as "compensation" under paragraph 12 of the agreement. The entirety of the parties' contractual stipulations simply leads to no other conclusion than that petitioner's "compensation" is actually its share in the income of the joint venture.

Article 1769 (4) of the Civil Code explicitly provides that the "receipt by a person of a share in the profits of a business is *prima facie* evidence that he is a partner in the business." Petitioner asserts, however, that no such inference can be drawn against it since its share in the profits of the Sto Niño project was in the nature of compensation or "wages of an employee", under the exception provided in Article 1769 (4) (b).[24]

On this score, the tax court correctly noted that petitioner was not an employee of Baguio Gold who will be paid "wages" pursuant to an employer-employee relationship. To begin with, petitioner was the manager of the project and had put substantial sums into the venture in order to ensure its viability and profitability. By pegging its compensation to profits, petitioner also stood not to be remunerated in case the mine had no income. It is hard to believe that petitioner would take the risk of not being paid at all for its services, if it were truly just an ordinary employee.

Consequently, we find that petitioner's "compensation" under paragraph 12 of the agreement actually constitutes its share in the net profits of the partnership. Indeed,

petitioner would not be entitled to an equal share in the income of the mine if it were just an employee of Baguio Gold.[25] It is not surprising that petitioner was to receive a 50% share in the net profits, considering that the "Power of Attorney" also provided for an almost equal contribution of the parties to the St. Nino mine. The "compensation" agreed upon only serves to reinforce the notion that the parties' relations were indeed of partners and not employer-employee.

All told, the lower courts did not err in treating petitioner's advances as investments in a partnership known as the Sto. Nino mine. The advances were not "debts" of Baguio Gold to petitioner inasmuch as the latter was under no unconditional obligation to return the same to the former under the "Power of Attorney". As for the amounts that petitioner paid as guarantor to Baguio Gold's creditors, we find no reason to depart from the tax court's factual finding that Baguio Gold's debts were not yet due and demandable at the time that petitioner paid the same. Verily, petitioner pre-paid Baguio Gold's outstanding loans to its bank creditors and this conclusion is supported by the evidence on record.[26]

In sum, petitioner cannot claim the advances as a bad debt deduction from its gross income. Deductions for income tax purposes partake of the nature of tax exemptions and are strictly construed against the taxpayer, who must prove by convincing evidence that he is entitled to the deduction claimed.[27] In this case, petitioner failed to substantiate its assertion that the advances were subsisting debts of Baguio Gold that could be deducted from its gross income. Consequently, it could not claim the advances as a valid bad debt deduction.

WHEREFORE, the petition is **DENIED**. The decision of the Court of Appeals in CA-G.R. SP No. 49385 dated June 30, 2000, which affirmed the decision of the Court of Tax Appeals in C.T.A. Case No. 5200 is **AFFIRMED**. Petitioner Philex Mining Corporation is **ORDERED to PAY** the deficiency tax on its 1982 income in the amount of P62,811,161.31, with 20% delinquency interest computed from February 10, 1995, which is the due date given for the payment of the deficiency income tax, up to the actual date of payment.

SO ORDERED.

Carpio Morales[*], *Chico-Nazario, nachura,* and *Reyes, JJ.*, concur.

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[1] *Rollo*, pp. 46-57; penned by Associate Justice Portia Aliño-Hormachuelos and concurred in by Associate Justices Ma. Alicia Austria-Martinez (now an Associate Justice of the Supreme Court) and Elvi John S. Asuncion.

[2] *Id*. at 169-196; penned by Justice Amancio Q. Saga.

[3] *Id*. at 59.

[4] *Id*. at 60-69.

[5] *Id*. at 62-63, 66 & 68.

[6] *Id*. at 124.

[7] *Id*. at 89-97.

[8] *Id*. at 98-106.

[9] *Id*. at 129.

[10] *Id*. at 148-149.

[11] *Id*. at 195.

[12] *Id*. at 46-57.

[13] *Id*. at 59.

[14] *Id*. at 18.

[15] CIVIL CODE, Art. 1767.

[16] *Aurbach v. Sanitary Wares Manufacturing Corporation*, G.R. No. 75875, December 15, 1989, 180 SCRA 130, 146-147.

[17] Power of Attorney, paragraph 2(a), *rollo*, p. 61.

[18] *Rollo*, p. 62.

[19] CIVIL CODE, Art. 1927. An agency cannot be revoked if a bilateral contract depends upon it, or if it is the means of fulfilling an obligation already contracted, or if a partner is appointed manager of a partnership in the contract of partnership and his removal from the management is unjustifiable.

[20] *Partnership, Agency and Trusts*, 1996 Ed., De Leon and De Leon, Jr., p. 330.

[21] See *Nielson & Company, Inc. v. Lepanto Consolidated Mining Company*, 135 Phil. 532, 542 (1968).

[22] *Rollo*, p. 63.

[23] CIVIL CODE, Art. 1953.

[24] Article 1769 (4) (b) of the Civil Code states:

> Art. 1769. In determining whether a partnership exists, these rules shall apply:
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> x x x x
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> (4) The receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business, but no such inference shall be drawn if such profits were received in payment:
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> x x x x
>
> (b) As wages of an employee or rent to a landlord;
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> x x x x

[25] See *Tocao v. Court of Appeals*, 396 Phil. 166, 180-182 (2000).

[26] *Rollo*, pp. 81-88.

[27] See *Law of Basic Taxation in the Philippines*, 2001 Revised Ed., Benjamin B. Aban, p. 119.

* In lieu of Associate Justice Ma. Alicia Austria-Martinez.
