

THY WILL BE DONE by Atty. Angelo M. Cabrera

CONDONATION OF DEBT AND ESTATE TAXATION

Condonation or remission of debt is a mode of extinguishing an obligation. It is an act of liberality, by virtue of which the creditor, without receiving any equivalent, renounces the enforcement of the obligation (Tolentino, Commentaries and Jurisprudence on the Civil Code of the Philippines). It simply means that by a generous act of a person who, for instance, lends money to another with an obligation to re-pay, the borrower is released from such obligation.

In estate taxation, indebtedness is an allowable deduction in the tax computation.

The interesting question is, what if the debt is condoned after the death of the debtor? Will the debt still be considered an allowable deduction?

These and more are answered in this case involving the estate of JF.

JF died in 1987. The probate court appointed a special administrator of JF's estate who proceeded to collate, determine and identify the assets and liabilities of said estate, prelude to the filing of an estate tax return. Eventually on April 17, 1990, an estate tax return was filed showing therein a NIL estate tax liability largely because of a number of outstanding bank indebtedness, which was treated as part of the allowable deductions in the estate tax computation. The BIR then issued certifications to the effect that taxes have been paid and that the properties may be transferred to the heirs of JF.

Later, it was discovered that the heirs, as represented by the administrator, entered into some compromise agreements with the creditors of the estate which effectively condoned some of the estate's indebtedness.

Upon discovery of such arrangement, the BIR issued an estate tax assessment notice demanding payment of the deficiency estate tax.

The administrator protested the assessment saying that the reckoning date of the claims against the Estate and the settlement of the estate tax due should be at the time the estate tax return was filed by the judicial administrator and the issuance of said BIR Certifications and not at the time the compromise agreements were entered into with the Estate's creditors.

Is the administrator correct?

Yes.

"Claims against the estate," are allowable deductions from the gross estate under Section 79 of the National Internal Revenue Code of 1997. The question is whether post-death

developments should be taken into consideration and the claim should be allowed as a deduction only to the extent of the amount actually paid.

The Supreme Court ruled in favor of the date-of-death valuation principle, made pursuant to the ruling of the U.S. Supreme Court in *Ithaca Trust Co. v. United States*, which declared that “the act on which the tax is levied occurs at a discrete time, *i.e.*, the instance of death, the net value of the property transferred should be ascertained, as nearly as possible, as of that time.”

Thus, the Supreme Court ruled that “*First*. There is no law, nor do we discern any legislative intent in our tax laws, which disregards the date-of-death valuation principle and particularly provides that post-death developments must be considered in determining the net value of the estate. It bears emphasis that tax burdens are not to be imposed, nor presumed to be imposed, beyond what the statute expressly and clearly imports, tax statutes being construed *strictissimi juris* against the government. Any doubt on whether a person, article or activity is taxable is generally resolved against taxation. *Second*. Such construction finds relevance and consistency in our Rules on Special Proceedings wherein the term “claims” required to be presented against a decedent’s estate is generally construed to mean debts or demands of a pecuniary nature which could have been enforced against the deceased in his lifetime, or liability contracted by the deceased before his death. Therefore, the claims existing at the time of death are significant to, and should be made the basis of, the determination of allowable deductions.” (based on G.R. No. 140944, April 30, 2008).

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