REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

STANDARD CHARTERED BANK,
Petitioner,

- versus -

C.T.A. CASE NO. 4703

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
OCT 20 1994

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D E C I S I O N

This is an appeal interposed by petitioner from a decision of respondent finding the former liable for deficiency income taxes in the amounts of ₱2,626,385.60 for the year 1982 and ₱2,899,025.60 for the year 1983.

There is no dispute as to the facts, the case having been submitted for decision by respondent on the basis of the pleadings and the records of the Bureau of Internal Revenue.

Petitioner is a resident foreign bank, duly organized and existing under the laws of the State of California, U.S.A., and is authorized to engage in business as a branch in the Philippines.

Petitioner received on November 17, 1987 Assessment Notices for Deficiency Income Tax for 1982 in the amount of ₱2,626,385.60, inclusive of interest, and Deficiency Documentary Stamp Tax for 1982 in the amount of P4,427,209.60, inclusive of compromise penalty. On November 24, 1987, petitioner filed a written protest with the respondent and requested for reconsideration and reinvestigation.

Then on February 3, 1988, petitioner received another assessment-demand letter, dated January 29, 1988, from respondent this time for deficiency income tax amounting to P2,899,025.00, inclusive of interest, and deficiency documentary stamp tax in the amount of P6,453,851.72, including compromise penalty, both for the year 1983. A formal protest was filed by petitioner on February 10, 1988. On April 15, 1988, petitioner filed a supplemental protest, dated April 12, 1988, consolidating the reasons why the 1982 and 1983 Deficiency Income and Documentary Stamp Tax Assessments should be cancelled.

In two letters, both dated August 20, 1991, received by petitioner through its auditors on December 20, 1991, respondent informed petitioner that the Deficiency Documentary Stamp Tax Assessments issued for the years 1982 and 1983 were considered closed and terminated by reason of the Compromise Agreement entered into between the Bureau of Internal Revenue and the Bankers Asociation of the Philippines (BAP) on April 4, 1988 where the tax liability had been settled and paid by virtue of said Agreement. However, with respect to the Deficiency Income Tax Assessments for the years 1982 and 1983, respondent denied petitioner's request for cancellation thereof instead she reiterated payment of the income taxes due stating further that this is her final decision on the matter.

An appeal with this Court was filed on January 17, 1992.

Petitioner contends that its alleged liability to pay deficiency income taxes for the years 1982 and 1983 in the amounts of P2,626,385.60 and P2,899,025.60, respectively, had been extinguished upon payment of the compromise amount of P302,776.93. The payment of P302,776.93 represented its final and full settlement of actual and subsisting assessments relative to the issue of disallowed interest expense allocable to non-taxable revenues and including assessable amounts for open and unassessed years up to and including the calendar year 1983 pursuant to the BIR-BAP Compromise Agreement which was accepted by then Commissioner Ruben B. Ancheta on October 31, 1984. The BIR issued the corresponding Authority to Issue Revenue Tax Receipt, covering the periods 1974 and 1978 up to 1983, in the sum of P302,776.93. Petitioner paid the Bureau P302,776.93, on September 20, 1984, as evidenced by BIR Payment Order No. B3819985 and CB Confirmation Receipt No. B4512030. Petitioner further invokes Section 30 (now 29) of the Tax Code where the law allows as a deduction from gross income ordinary and necessary business expense paid and incurred during the taxable year in order to carry on its trade or business. Thus, the expenses claimed as a deduction should be allowed as long as they qualify under Section 30 of said Code.

Respondent alleged that the disallowance of that portion corresponding to interest expense allocable to tax-exempt revenue realized by petitioner was proper in the light of BIR Ruling, dated August 6, 1986, issued by then Commissioner Bienvenido A. Tan, Jr., to Orient Pacific Capital Corporation, quoted as follows:

> "In other words, only deductions which produced the taxable income can be claimed for income tax purposes. Consequently, deductions which produced the non-taxable income cannot be claimed as against taxable income, as in the instant case of your client."

The issue is whether or not petitioner is liable to pay the alleged deficiency income taxes for the years 1982 and 1983 by reason of the disallowance of that portion of interest expense allocable to non-taxable revenues even if the same fall part of the subject of the compromise agreement entered into by both parties.

We answer in the negative.

Indeed there was a Compromise Agreement executed on July 17, 1984 by and between petitioner, a member of the Bankers Association of the Philippines, and the BIR which was accepted by then Commissioner Ruben B. Ancheta, which reads at the time as follows: (pp. 291-295, BIR records)

"<u>COMPROMISE AGREEMENT</u>

> <u>The Chartered Bank,</u> hereinafter referred to as "the Bank", member of the Bankers Association of the

Philippines, through its duly authorised representative, hereby offers to compromise its income tax liabilities relating to disallowed interest expense, under the following terms and conditions:

1. The Bank agrees to pay TEN PERCENTUM (10%) of basic deficiency income tax liabilities arising from, or to the extent attributable to, disallowance of interest pertaining to obligations considered by the Bureau of Internal Revenue as incurred or continued to purchase or carry securities, the income of which is exempt from income tax. The term "income tax" as used in this agreement shall include the applicable corporate development tax.

2. The income tax liabilities abovementioned contemplate and include:

a) Actual and subsisting assessments, insofar as and/or to the extent that the same involve the issue of disallowed interest above-mentioned;

b) Assessable amounts for open and unassessed years up to and including the calendar year 1983.

3. Existing deficiency assessments shall be recomputed, and assessable amounts shall be computed, on the basis of the following two-step formula:

STEP 1

$$\frac{\text{Average of interest-bearing obligations (excluding foreign currency obligations)}}{\text{Average of total liabilities and equity (excluding total foreign currency obligations)}} \times \text{Average investment in securities exempt from income tax} = \text{Product}$$

STEP 2

Product of Step 1 / Average of interest-bearing obligations (excluding foreign currency obligations)	X	interest expense for the year (excluding interest paid or accrued on foreign currency obligations)	=	Disallowed interest expense

4. The compromise amount determined in accordance with Conditions 1, 2 and 3 above shall be payable in installments in accordance with the attached shchedule of payments; Provided however, that if any installment is not paid on the due date thereof, 10% surcharge and interest at thirty-six percentum (36%) per annum shall be imposed on such delinquent installment from date due until full payment thereof.

5. The Bank shall be responsible for submitting its recomputations of actual and subsisting assessments, and computations for amounts assessable for open and unassessed years, pursuant to Condition No. 3, as well as the particular schedule of payments applicable thereto, based on the schedule established in the attached schedule of payments, and shall be likewise be responsible for substantiating the figures used in such computations.

6. Other issues raised in the income tax assessments or which may be raised in income tax assessments for open and unassessed years not involving disallowed interest on indebtedness incurred or continued to purchase or carry tax-exempt securities are not included in, nor affected by, this compromise; Provided, however, that in assessments for years where the taxpayer showed a net loss per return, and other items of disallowance (or additional income) exist together with the issue of disallowed interest contemplated in this compromise agreement,

such net loss per return shall be pro-rated between the disallowed interest subject of this compromise agreement and the items attributable to other issues. The compromise shall be final regardless of the final outcome of the assessment with respect to the other issues.

7. In case a net loss per return is reported in an open or unassessed year, the compromise amount shall be determined as follows:

a) If the disallowed interest contemplated in this compromise agreement exceeds the loss per return, the compromise amount shall provisionally be based upon such excess subject to readjustment in accordance with Condition No. 6 of this agreement upon the termination of the regular examination by the BIR; and

b) If the disallowed interest contemplated in this compromise agreement is not sufficient to cover the loss per return, the determination of the compromise amount shall be held in abeyance until after the termination of the regular examination by the BIR.

8. The early determination of the compromise amount based on recomputations submitted by the Bank involving Conditions Nos. 1, 2 and 3 of this agreement shall not preclude the BIR from imposing an additional amount upon the verification of book entries and other documents in support of such recomputation which verification shall, however, not exceed a period of one (1) year from the date of the signing of this agreement in the case of actual and subsisting assessments or until such time as the regular examinations, which may be conducted at a later date, is officially terminated or is barred by the statute of limitations, with respect to open or unassessed years.

9. For years already assessed where the issue of disallowed interest had not been raised, no computation or compromise payment need be made,

and no revision of the assessment to include this issue shall be made.

10. Upon the execution of the agreement, cases pending before the Court of Tax Appeals involving solely the issue subject of this agreement shall be withdrawn by the parties, provided that the petitioner shall execute and submit a waiver suspending the prescriptive period for collection of the pertinent tax liability of the Bank, pending compliance with the terms of this agreement and the Schedule of Payments annexed hereto.

11. A BIR ruling shall be issued to the effect that, beginning with calendar year 1984, the exception under Section 30(b) of the National Internal Revenue Code regarding deductibility of interest on obligations incurred or continued to purchase or carry securities the income from which is exempt from income taxation, shall not be applicable to commercial banks, who are signatories to this agreement.

Done in Manila.

17th day of July, 1984.

The Chartered Bank
(Bank)

By: (SGD.)
R. O. YOUNG
TAN 0101-258-2

ACCEPTED:

(SGD.)
RUBEN B. ANCHETA
Commissioner of Internal Revenue
TAN: A5239-J1139-A-0

Diliman, Quezon City
October 31, 1984."

This brings us to the definition of the term "compromise". Article 2028 of the Civil Code of the Philippines provides:

> "A compromise is a contract whereby the parties, by making reciprocal concessions, avoid a litigation or put an end to one already commenced."

From said definition, it is obvious that the "Compromise Agreement" dated July 17, 1984 entered into by the parties to this action wherein the signature of petitioner's representative and that of the Commissioner of Internal Revenue appear, partook of the nature of a compromise. The payment of the amount of P302,776.93 extinguishes petitioner's liability to pay deficiency income taxes for the years 1974, 1978 up to 1983.

Section 295 (now 204) of the Tax Code allows the Commissioner of Internal Revenue to compromise the payment of any internal revenue tax when a reasonable doubt as to the validity of the claim against the taxpayer exists or when the financial position of the taxpayer demonstrates a clear inability to pay the assessed tax. Thus, having exercised the power to compromise, the Commissioner by accepting said compromise agreement and issuing the Authority To Issue Revenue Tax Receipt and having received the compromise amount of P302,776.93 clearly indicated respondent's willingness to put an end to petitioner's obligations arising from any deficiency income tax assessments on account of the disallowance of interest pertaining to obligations incurred to purchase or carry securities the income of which is exempt from the income tax up to the year

1983. Hence, for all intents and purposes, the parties maybe considered to have entered into a compromise agreement to put an end to this appeal thru the rendition of a judgment, as prayed for by them, incorporating such agreement or stipulation. **(See Republic of the Philippines v. Marcelo B. Garay, L-21416, December 31, 1965, 15 SCRA 695; ANSCOR Container Corporation v. Commissioner of Internal Revenue, CTA Case No. 3444, May 30, 1985.)**

In view of the foregoing discussion we find it unnecessary to delve on the issue of the correctness of the disallowance of that portion pertaining to deductions of interest corresponding to non-taxable revenues. We find the same having become moot by reason of the compromise agreement entered into by both parties.

WHEREFORE, We find the petition for review meritorious and the same is hereby **GRANTED**. Respondent's decision dated August 20, 1991 is reversed and set aside. The Deficiency Income Tax Assessments issued by respondent against petitioner for the years 1982 and 1983 are considered cancelled. No costs of suits.

SO ORDERED.

MANUEL K. GRUBA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

RAMON O. DE VEYRA
Associate Judge

CERTIFICATION

I hereby certify that this decision was reached after due consultation among the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals