REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PHILIPPINE COMMERCIAL INTERNATIONAL BANK,
as successor-in-interest of Insular Bank of Asia & America,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 5003

Promulgated:
FEB 04 1997

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DECISION

Before Us is a petition for review of the decision of the Commissioner of Internal Revenue denying petitioner's protest against its deficiency income tax assessment amounting to P67,688,476.65 for the year 1984.

Petitioner is a domestic corporation organized and existing under and by virtue of the laws of the Philippines. It is authorized to engage in business as a private universal bank. On November 25, 1985, in a merger between Insular Bank of Asia and America (IBAA) and Philippine Commercial International Bank (PCIBank), petitioner was designated as surviving corporation with all the rights, privileges, immunities, franchises, liabilities and obligations of each of the constituent corporations.

This case originated from a letter, dated May 5, 1987, filed by petitioner with herein respondent claiming for additional tax credit in the amount of P3,454,494.52, representing 15% income tax withheld on income derived from government securities computed as follows: (p. 292, BIR rec.)

PCIBank (for 1986)	P2,415,347.45
IBAA (for 1982 to 1985)	1,039,147.07
Total	P3,454,494.52

During the examination of petitioner's claim for tax credit, there was found the following note to the 1985 Financial Statements of IBAA (pp.362-363, BIR rec.):

"7. PRIOR PERIOD ADJUSTMENTS

The balance of retained earnings at December 31, 1984 has been restated from amounts previously reported to reflect retroactive credits and charges for the following:

	Credits (Charges)
Reversal of the capitalized interest and penalties on loans restructured in 1983 and 1984	(P 1,282,977)
Revaluation of FCDU accounts	(2,705,186)
Revaluation of the principal amount of forward contracts in 1984	77,422,136
Accretion of discount in	

bonds in 1984	90,998
Accrual and revaluation of the anticipated interest on forward contracts in 1984	9,883,815
Adjustments to restate undivided profits at historical rates	10,468,430
Provision for probable losses on real and other properties owned or acquired and loans outstanding in 1984	(15,224,625)
	P78,652,591

Net income for this year would have been increased or decreased by the same amount."

On account of this finding, respondent, in a letter dated October 13, 1988 (pp. 381-382, BIR rec.), requested PCIBank for evidences of income tax payments for the additional net earnings in 1984 amounting to P78,652,591.00 as disclosed in the 1985 Notes to Financial Statements (see Note No. 7). Petitioner was also advised that its failure to submit the same within ten (10) days from the receipt of said letter will be understood that corresponding internal revenue taxes due therefrom had not been paid (pp. 381-382, BIR rec.).

Respondent, not having received any reply from the petitioner, sent a letter, dated January 6, 1989 (Exh. 2, pp. 383-384, BIR rec.) informing PCIBank of the following findings:

"COMPUTATION OF INCOME TAX DEFICIENCY FOR 1984

Net Income per 1984 Return		₱ 1,213,513.00
Add: Additional "Net Earnings in 1984" disclosed in 1985 Financial Statement	₱78,652,591.00	
Add back-provision for losses	15,224,625.00	93,877,216.00
Net Income per review		₱95,090,729.00
Income Tax Due Thereon		33,271,755.00
Less: Additional Tax Credit 1982-1985		1,039,147.07
Deficiency Income Tax		₱32,232,607.93
50% Surcharge for Intentional Neglect		16,116,303.96
Interest (60% Maximum)		19,339,564.76
TOTAL		₱67,688,476.65

On the same letter, petitioner was also invited to an informal conference within ten (10) days from receipt of said letter in order that it can present its side of the case.

In a memorandum, dated April 6, 1989 (Exh. 4, pp. 394-396, BIR rec.) issued by Pedro S. Acuña, Officer-in-Charge (National Assessment Office), addressed to the Commissioner of Internal Revenue, it was alleged that petitioner never seriously sat down to discuss the issue or submit any position paper on the matter, except the simple allegation that said income is for financial purposes only. The same memorandum averted the following:

> "The above note is a clear admission that certain income for the year 1984 was not declared during said year. This net earning was adjusted in the Retained Earnings to correctly reflect the value of the capital resources of the bank necessary in concluding the merger of PCIBank and IBAA on November 25, 1985.
>
> With the amount so huge in proportion to the reported income for 1984, it was inescapable to conclude that the failure to amend the 1984 income tax return and paid corresponding tax due thereon is purely intentional and fraudulent subject to fraud penalty."

On April 13, 1989, respondent issued a letter (Exh. 6, p. 399, BIR rec.) and Assessment Notice No. FAN 1-84-89-000648 (Exh. 5, p. 402, BIR rec.) for the amount of ₱68,688,476.65, representing deficiency income tax for the year 1984. Petitioner received the assessment letter on April 19, 1989 (Exh. A-2. p. 9, CTA rec.). Through its external auditor, SGV and Co., petitioner filed on May 9, 1989 a letter-protest against the assessment (Exh. B, p. 10-14, CTA rec.). This was denied by the respondent in a letter, dated March 10, 1993 (Exh. C, pp. 15-18, CTA rec.).

Hence, this petition which raises two main issues, namely:

(1) whether or not the Bureau of Internal Revenue's right to assess has prescribed, and if in the negative;

(2) whether or not petitioner is liable for deficiency income tax for the year 1984.

Anent the first issue, petitioner stated that the right of the government to assess petitioner for deficiency income tax for the year 1984 was only up to April 15, 1988 (three years from filing of return on April 15, 1985) but the assessment notice was mailed only on April 15, 1989 or 365 days after the lapse of the reglementary period. Section 318 (now 203) of the Tax Code, as amended by Batas Pambansa Blg. 700, provides that:

> "**SEC. 318.** ***Period of limitation upon assessment and collection.*** — Except as provided in the succeeding section, internal revenue taxes shall be assessed <u>within three years after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment for the collection of taxes shall be begun after the expiration of such period:</u> *Provided*, That in a case where a return is filed beyond the period prescribed by law, the three-year period shall be counted from the day the return was filed. For the purposes of this section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day." (Underscoring supplied)

Respondent does not dispute that the assessment was issued beyond the three-year period to assess but it contended that the instant case is not covered by the abovementioned section but by Section 319(a) [now 223(a)] of the same Code which states that:

> "**SEC. 319.** ***Exceptions as to period of limitation of assessment and collection of taxes.*** — (a) In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at anytime within <u>ten years after the discovery of the falsity, fraud or omission</u>: **Provided,** That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in a civil or criminal action for the collection thereof."

The respondent Commissioner asserted that it was clear that there was falsity or grave omission of a material undeclared income in order to reduce the tax due the government. Its failure to report as part of income the revaluation of forward contracts of IBAA is tantamount to fraud. Thus, instead of amending its 1984 income tax return which reported a taxable net income of P1,213,513.00, the income of P78,652,591.00 was made to appear as prior period adjustments for 1985. Understandably so, according to respondent , because for 1985 the income tax return reported a net loss of P157,053,275.00. So that even if the prior period adjustments of P78,652,591.00 would be treated as additional taxable income for 1985, the return would still be a loss and would have no tax effect. As pointed to by the respondent, this scheme is tax evasion pure and simple. Even assuming that there was no intent to defraud the government, IBAA's 1984 Income Tax Return was false since it deviated from the truth, whether intentional or not. It is enough that there was deviation from the truth as distinguished from a fraudulent return (Aznar vs. Court of Tax Appeals, 58 SCRA 519). The ten-year period to assess is the one applicable.

After a thorough evaluation of the documentary evidence presented by both parties and the testimonies of their witnesses, this Court finds the contention of the respondent Commissioner unmeritorious. Fraud must be proved to exist by clear and convincing evidence amounting to more than mere preponderance, and cannot be justified by a mere speculation because fraud is never lightly to be presumed **(Vitelli and Sons vs. U.S., 250 U.S. 355; Duffin vs. Lucas, 55 F (2d) 786; Budd vs. Comm., 43 F(2d) 509; Arroyo vs. Granada, et al., 18 Phil 484).** There is no evidence on record that the petitioner purposely sought to report the alleged income as prior year adjustment in the 1985 Financial Statements of IBAA to evade the payment of income tax.

The said revaluation of forward contracts (referring to the agreement between IBAA and the Central Bank to exchange different currencies at a specified exchange rate at an agreed-upon future date) was made by the petitioner to reflect the true financial condition of IBAA due to the appreciation of the US dollar as against the Philippine Peso in 1984. This was done in view of the merger of IBAA and PCIBank. Petitioner's witness, Ms. Mina Tablanza (Auditor of SGV), explained that at the time these forward contracts were acquired from the Central Bank to pay off its foreign debts, the exchange rate between the US Dollar and the Philippine Peso was much lower as against the exchange rate in 1984.

Thus, as of December 31, 1982, one US Dollar was equivalent to ₱9.1710 Philippine Pesos (Exh. H-1, p. 57, CTA rec.), as compared in December 28, 1984, where one US Dollar was equivalent to ₱19.787500 Philippine Pesos (Exh. G-1, p. 56, CTA rec.). Since there was a depreciation of the peso from 1982 to 1984, its auditors adjusted the books of IBAA in 1985 to reflect the true value thereof (TSN, February 21, 1994 Hearing, pp. 8-9). And because of a foreign debt moratorium in 1983 (Exh. E, p. 54, CTA rec.), the foreign contracts were only delivered sometime in 1986 by the Central Bank (Exhs. D and D-1, p. 53, CTA rec.). When the transactions on these forward contracts, which comprises the bulk of the alleged undeclared income, were realized and completed in 1986, the corresponding income thereon was reported in the petitioner's 1986 Financial Statements (Exh. J, pp.

62-76, CTA rec.). A mere increase in value of the foreign currency prior to its realization (or receipt) cannot be considered as income.

It is also significant to note that the imposition of a 50% surcharge was for "intentional neglect" and not fraud. Under Section 72 [now 248] of the Tax Code, as amended, quoted hereunder, to wit:

> "**SEC. 72. Surcharges for failure to render returns; for rendering false and fraudulent returns; and for failure to file income tax returns in the proper revenue office.** – In case of willful neglect to file the return or list required under this Title within the time prescribed by law, or in case a false or fraudulent return or list is willfully made, the Commissioner of Internal Revenue shall add to the tax or to the deficiency tax, in case any payment has been made on the basis of such return before the discovery of the falsity or fraud, a surcharge of fifty *per centum* of the amount of such tax or deficiency tax. x x x."

It is an apparent indication that, at the outset, respondent Commissioner was not convinced that petitioner's return was fraudulent. It was only when petitioner raised the issue of prescription that respondent belatedly claimed the existence of fraud.

Even more revealing of the unsupported allegation of fraud by the respondent is the hasty issuance of the transcript of **assessment** which was merely based on the Memorandum of Pedro S. Acuña, dated March 29, 1989 (Exh.

3), addressed to the Chief of National Audit Review Division (NARD) which stated that:

> "Since we could not think and conceive of any income of banks that will fit the above category of income and <u>considering that the prescriptive period to assess the corresponding tax due thereon is fast approaching,</u> let us issue the transcript of assessment thereof by the Collection Service."

This fact was confirmed by the witness for the respondent, Abelardo T. Quindo, the Revenue Enforcement Officer who signed the transcript of assessment issued to the petitioner, when he testified before this Court. A portion of his testimony (TSN, October 20, 1994 Hearing, pp. 30-31) is quoted hereunder:

"Q. Based on this letter you immediately prepared the transcript of assessment?

A. Yes, based on the memo of Mr. Acuña ordering NARD to prepare the transcript of assessment because the case is about to prescribe.

Q. You are referring to the memo dated March 20, 1989 previously marked as Exhibit "3" for the respondent?

A. Yes.

Q. So what was the specific instruction of Mr. Acuña in that memo?

A. To issue transcript of assessment.

Q. What was the reason given by Mr. Acuña?

A. The case was about to prescribe.

Q. So this period covered calendar year 1984?

A. Yes."

Both Pedro Acuña and Abelardo T. Quindo, Officers of the Bureau of Internal Revenue mistakenly thought that the prescriptive period of three years will expire on April 15, 1989 since the alleged undeclared income for 1984 was found as prior period adjustment in petitioner's 1985 Financial Statements filed on April 15, 1986.

This Court is verily convinced that the assessment was issued for fear of prescription and that no fraudulent act was discovered as having been committed by the petitioner. Neither was there falsity in the preparation or filing of the 1984 Income Tax Return of IBAA. Had petitioner concealed this information, then it would not have had reported it in 1985. Hence, the applicable prescriptive period is three years (3) years as provided under Section 318 [now 203] of the Tax Code, as amended, and not ten (10) years as provided under Section 319(a) [now 223(a)] of the same Code. Respondent's disputed assessment is now barred by prescription.

WHEREFORE, in view of all the foregoing, this petition is hereby **GRANTED.** Accordingly, the deficiency income tax assessment in the amount of P67,688,476.65

issued against the petitioner for the year 1984 is ordered **CANCELLED.**

SO ORDERED.

RAMON O. DE VEYRA
Associate Judge

I CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

CERTIFICATION

I hereby certify that this decision was reached after due consultation with the member 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