REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

CITYTRUST BANKING CORPORATION,
Petitioner,

- versus -

C.T.A. CASE NO. 5261

THE COMMISSIONER OF INTERNAL REVENUE
Respondent.

Promulgated:
JAN 28 1998

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DECISION

This is a petition seeking for the withdrawal and cancellation of an assessment for alleged deficiency income tax for 1984 in the amount of P3,870,238.40 resulting from the disallowance of the allocated portion of business expenses in the amount of P1,627,923.70.

The antecedent facts of the case are as follows:

Petitioner is a domestic corporation duly organized and existing under and by virtue of the laws of the Philippines and is primarily engaged in the banking business.

On May 2, 1989, petitioner received Assessment Notice No. FAS-1-84-88-003291 (Annex "A", Petition) and demand letter (Annex "B", Petition) issued by the respondent for alleged deficiency income tax assessment for 1984 in the amount of P3,870,238.40. computed as follows:

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Net income per return		P13,501,522.00
Add: FCDU/Expenses charged to regular banking operations	P1,481,391.49	
Trading loss on equity investments	2,786,361.00	
Expenses allocated to tax-exempt income	1,627,923.70	
Rental expenses	1,015,465.15	6,911,141.54
Net income per examination		P20,412,663.54
Income tax due:		
First P100,000.00 x 25%		P 25,000.00
Next P20,312,664.00 x 35%		7,109,432.00
Total Income Tax Due		P 7,134,432.00
Less: Tax due per return		4,715,533.00
Deficiency tax		P 2,418,899.00
Add: Interest fr. 4/15/85 to 4/15/88		1,451,339.40
TOTAL AMOUNT DUE AND COLLECTIBLE		P 3,870,238.40

On May 9, 1989, petitioner filed its protest (Annex "C", Petition) against the aforementioned assessment, followed by a supplemental protest (Annex "D", Petition) filed by petitioner through its auditor, SGV & Co., on January 12, 1990.

Through a letter, constituting her final decision (Annex "E", Petition), respondent reduced the subject income tax assessment to P3,301,578.19 computed as follows:

Net income per return		P13,501,522.00
Add: FCDU expenses	P1,481,391.49	
Trading loss	2,786,361.00	
Expenses allocated	1,627,923.70	5,895,676.19
Taxable net income per review		P19,397,198.19
Tax due thereon		6,779,019.37
Less: Tax due per return		4,715,533.00
Deficiency tax		P 2,063,486.37
Add: 20% Interest fr. 4/15/85 to 4/15/88		1,238,091.82
TOTAL AMOUNT DUE AND COLLECTIBLE		P 3,301,578.19

Petitioner has agreed to the disallowance of FCDU expense and trading losses in the amounts of P1,481,391.49 and P2,786,361.00, respectively, but disagrees on the disallowance of alleged "expenses allocated to non-taxable income" amounting to P1,627,923.70, hence, on June 23, 1995, the instant Petition for Review was filed.

Petitioner argued that Section 29(a)(1)(A) of the Tax Code, which defines deductible business expenses, permits the deduction of business expenses from the gross income regardless of whether or not such expenses are allocable to taxable or non-taxable income. Petitioner added that all that is required by law for business expenses to be deductible is that they satisfy the following three essential elements:

a. The expense must be both ordinary and necessary;
b. The expense must be paid or incurred during the taxable year; and
c. The expense must be incurred in carrying on a trade or business.

Furthermore, petitioner strongly disputed the method of allocation employed by the respondent for lack of factual basis, considering that complete accounting records were made available to the examiner during the examination. It asserted that actual expense allocable could have been readily verified from petitioner's accounting records instead of relying on an erroneous formula which is obviously an indirect method of examination.

For her part, respondent disallowed an allocated portion of business expenses deducted by the petitioner from its gross income on the ground that it

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pertained to tax-exempt income of the petitioner. She claims that under the generally accepted accounting principle of matching of revenue and expenses, where the expenses incurred were not related to the generated income, said expenses must not be allowed as deductible for purposes of income taxation.

Considering that the 1984 gross income derived by the petitioner from its regular banking operations amounts to P516,710,808.00 and the non-taxable income of the petitioner from government securities, bank deposits, and trading of securities is in the sum of P28,087,494.00 as opposed to its total claimed deductible expense of P29,948,085.33, respondent arrived at the disputed disallowed allocated expense of P1,627,923.70 computed as follows:

$$\frac{\text{P } 28{,}087{,}494.00}{\text{P}516{,}710{,}808.00} \times \text{P}29{,}948{,}085.33 = \underline{\text{P}1{,}627{,}923.70}$$

On the allegation of the petitioner that the method of allocation employed by the respondent lacks factual basis, respondent contended that since petitioner failed to substantiate by positive evidence what expenses are attributable to the non-taxable income, the proportionate ratio formula she applied to determine the expenses attributable to it was proper.

This Court is now tasked to resolve the lone issue of whether or not petitioner is liable for the alleged deficiency income tax assessment for the year 1984 resulting from the disallowance of the allocated portion of business expenses in the amount of P1,627,923.70.

We hold in favor of the respondent.

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This is not a case of first impression. The foregoing issue had long been settled by this Court in the case of ***Hospital De San Juan De Dios , Inc. vs. Commissioner of Internal Revenue, CTA Case No. 1693, August 29, 1969 and affirmed by the Supreme Court on May 10, 1990, 185 SCRA 273***, where it was held that expenses incurred in the administration or management of investments are not allowable business expenses inasmuch as they were not incurred in 'carrying on any trade or business' within the contemplation of Section 29(a)(1)(A) of the Revenue Code. A pertinent portion of the aforesaid decision is quoted hereunder for emphasis:

> "The Court of Tax Appeals found that the interests and dividends received by the petitioner "were merely incidental income to petitioner's main activity, which is the operation of its hospital and nursing schools [hence] the conclusion is inevitable that petitioner's activities never went beyond that of a passive investor, which under existing jurisprudence do not come within the purview of `carrying on any trade or business' (pp. 47-48, Rollo). That factual finding is binding on this Court. And as the principle of allocating expenses is grounded on the premise that the taxable income was derived from carrying on a trade or business, as distinguished from mere receipt of interests and dividends from one's investments, the Court of Tax Appeals correctly ruled that said income should not share in the allocation of administrative expenses (p. 49, Rollo)." (underscoring supplied)

This Court accedes with the method of allocation employed by the respondent in computing the proportionate share in the expenses of the non-taxable income of the petitioner, for the same was resorted to by the respondent only after examination of the books of accounts of the petitioner as testified by Mr. Manuel San Pedro (TSN, October 10, 1995, pp. 13-14), respondent's witness, who personally examined the accounting records of the petitioner, to wit:

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"Q. Mr. Witness, you said that you examined the books of accounts of Citytrust Banking Corporation?

A. Yes.

Q. Did you personally go over those books in each and every document?

A. Yes.

Q. Are you certain from the books of accounts whether or not those expenses incurred by the company resulting from taxable transactions or the non-taxable transactions?

A. Definitely, you cannot compute an income unless you incurred expenses. What we are recording here are expenses pertaining to tax exempt income wherein we used allocations and these allocations that we mailed was in accordance as I said numbers of BIR Rulings on August 28, 1986.

Q. Mr. Witness, you said that in your report you disallowed P1,627,923.17?

A. Yes.

Q. And you allocate these expenses to the non-taxable transactions of the company?

A. Yes.

Q. Were the company able to refute or if other documents in support of the fact that this P1,627,923.17 were in fact incurred in connection with the income derived from non-taxable transactions?

A. The taxpayer during my examination did not send expenses identified which is the tax exempt income. That is why we resort to the allocations. This is what I am telling this court that this is in accordance with the BIR Ruling on August 6, 1986."

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Apparently, petitioner was not able to refute by positive and convincing documentary evidence the allocated expenses disallowed by respondent pertaining to petitioner's non-taxable income. The portion of the operating expenses which produced the non-taxable income does not appear in petitioner's records. Respondent maintains that "in the absence of adequate evidence on which to base a more reasonable allocation of office expenses between taxable and non-taxable income, such expenses are held allocable to each type of income in the proportion that each type bears to the total taxable and non-taxable income for the year, and that portion allocated to the non-taxable income is non-deductible" ***(William H. Jamison vs. Commissioner of Internal Revenue, 8 TC 173, January 28, 1947).***

Furthermore, respondent has the power to assess the proper tax on the best evidence obtainable ***(Section 16(b),Tax Code)*** and is authorized under ***Section 38 of the National Internal Revenue Code,*** to compute the net income in accordance with such method as in his opinion clearly reflects the income of the taxpayer.

Therefore, considering that petitioner had already paid the amount of P2,405,940. 90 as evidenced by the machine validated Authority to Accept Payment No. 2233271 (Exh. "E") issued by the respondent, petitioner is still liable to pay the balance of P895,637.29 computed as follows:

Total amount due and collectible	P3,301,578.19
Less: Payment made on July 14, 1995	2,405,940.90
Unpaid balance still due and collectible	P 895,637.29

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WHEREFORE, in view of all the foregoing, the instant Petition for Review is hereby **DENIED** and petitioner is ordered to pay the amount of P 895,637.29 representing the unpaid balance of deficiency income tax assessment issued by respondent for taxable year 1984.

SO ORDERED.

RAMON O. DE VEYRA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

AMANCIO Q. SAGA
Associate Judge

CERTIFICATION

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

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