REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PRODUCERS BANK OF THE PHILIPPINES,
Petitioner,

- versus -

C.T.A. CASE NOS. 4436 AND 4811

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
JUN 24 1998 GrApolinario

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DECISION

These are twin petitions questioning the assessments issued by respondent for the alleged non-payment of withholding tax on interest paid to a foreign corporation for the years 1985 and 1986.

Petitioner is a commercial banking corporation duly organized and existing under Philippine laws. On various dates, it opened Letters of Credit (LC) in favor of Samsung Co., Ltd. (Samsung) for the account of Fertilizer Marketing Co. of the Philippines, Inc. (FERMAP), to cover the importation of complete fertilizer from Korea to the Philippines, as follows:

LC No.	Date Opened	Amount	Due Date	Bill of Lading Date
15151	12/18/82	$943,624.00	360 days	12/17/82 after B/L date
15924	08/01/83	580,866.00	90 days	08/11/83 after B/L date
15922	08/01/83	365,860.00	90 days	09/13/83 after B/L date

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Sometime in August, 1983, the Government of the Philippines suffered a foreign exchange crisis which resulted in the default in the payment of its foreign debts. On October 24, 1983, the Central Bank of the Philippines (CB) was forced to issue Circular No. 966, effective October 25, 1983 (Exh. AA), compelling all banks to sell to the CB 80% of all their foreign exchange receipts. This Circular was later on amended by Circular No. 970, dated November 4, 1983 (Exh. BB), requiring all banks to sell to the CB all of their foreign exchange receipts.

As a consequence, petitioner was not able to pay the drafts drawn on the abovementioned letters of credit when they fell due. These drafts remained unpaid until the CB issued Circular No. 1010, dated June 6, 1984 (Exh.CC), reducing the 100% foreign exchange receipts surrender to 80% followed by Circular No. 1023, dated September 6, 1984 (Exh. DD), further reducing the percentage of surrender to 79.5%.

With the minimal allowable foreign exchange retention, the petitioner negotiated for a payment on installment of its unpaid drafts. During the negotiations, Samsung, through its correspondent bank, allegedly refused to pay any tax on the interest that will be imposed principally due to the delay in the payment of the drafts. Thus, the petitioner paid Samsung the sums assessed as interest on foreign loans but which petitioner alleges to be damages for breach of contract.

On February 7, 1989, petitioner received from respondent Letter of Assessment No. FAS-I-85-89-000163 (subject of CTA Case No. 4436), dated January 27, 1989, demanding payment of the total amount of P751,540.79 representing petitioner's 1985 deficiency withholding tax on interest paid to a foreign corporation in the sum of P406,076.11 as basic tax; P101,519.02 as 25% surcharge; P243,645.66 as interest and P300.00 as compromise penalty. Said assessment was protested by petitioner through a letter, dated February 24, 1989, which protest was denied by respondent in her letter, dated February 22, 1990, and which was received by petitioner on March 15, 1990, this time assessing the latter the total amount of P940,589.54, consisting of P406,076.11 as basic tax; P203,038.06 as surcharge; P331,175.37 as interest and P300.00 as compromise penalty. According to respondent, the 25% surcharge was adjusted to 50% in view of petitioner's failure to file the withholding tax returns as required by Section 319 of the Tax Code.

On January 18, 1990, petitioner again received from respondent Letter of Assessment No. FAS-1-86-89-00074 (subject of CTA Case No. 4811), dated January 7, 1990, demanding payment of the sum of P660,532.54, representing petitioner's 1986 deficiency withholding tax on interest paid on foreign loan in the sum of P274,750.56 as basic tax; P137,375.28 as surcharge; P240,406.70 as interest and P8,000.00 as compromise. The petitioner protested said assessment in a letter, dated February 11, 1990, which was received by respondent on February 13, 1990.

On several occasions beginning May up to July, 1990, petitioner's counsel conferred with examiners of the Banks, Insurance and Financing Division of the BIR and explained why the aforesaid assessments should be withdrawn. Thereafter, the matter was no longer raised until April 27, 1992 when petitioner was served with a Warrant of Distraint and/or Levy on its properties while the resolution of the protest was pending.

Petitioner then filed these petitions on April 6, 1990 (CTA Case No. 4436) and May 27, 1992 (CTA Case No. 4811).

In her Answer, respondent raised the following Special and Affirmative Defenses:

CTA Case No. 4436:

> "8. The books of accounts of the petitioner have correctly classified the payments to suppliers or beneficiaries of the letters of credit as interest payment which, by its nature, is subject to the withholding tax at source.
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> 9. The assessment has not prescribed since this case involves tax evasion arising out of petitioner's willfull refusal to pay the withholding tax on interest payments and, therefore, subject to the 10-year prescriptive period under Sec. 319 (a) of the Tax Code, as amended.

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10. The assessment in question was issued in accordance with law and revenue regulations.

11. All presumptions are in favor of the correctness of the tax assessments. The taxpayer has the burden of proof to impugn its validity (Interprovincial Autobus Co., Inc. vs. Collector of Internal Revenue, 8 SCRA 575 [1961])."

CTA Case No. 4811:

"5. This Honorable Court has no jurisdiction to take cognizance of the instant petition, there being no final decision yet by the respondent appealable to it;

6. Petitioner during the year under review (1986), paid interest to foreign banks on its foreign loans or on its bills payable, in the total amount of P 1,331,670.40;

7. Upon investigation conducted by the Revenue Enforcement Officer of respondent's Bureau, it was ascertained that petitioner failed to withhold the corresponding withholding tax on its aforesaid interest payments in the amount of P 274,750.56 thereby resulting in the herein assessment for deficiency withholding tax for the year 1986 in the amount of P 660, 532.54, inclusive of 50% fraud penalty and interest incident to delinquency;

8. The herein deficiency withholding tax assessment No. FAS-1-86-89-000074 dated January 9, 1990, is in accordance with law, and pertinent BIR implementing rules and regulations;

9. Section 51 (e)(2) of the Tax Code, as amended provides:

> `**Section 51(e)(2)**.-*Non-resident foreign corporations*.-In the case of foreign corporations subject to tax under this Title, not engaged in trade or business within the Philippines, there shall be deducted and withheld at the source in the same manner and upon the same items provided

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> in subsection (b)(1) of this section, as well as on remunerations for technical services or otherwise, a tax equal to thirty-five per centum (35%) thereof; Provided, That interest on foreign loans shall be subject to withholding tax of fifteen per centum (15%). This tax shall be returned and paid in the same manner and subject to the same conditions as provided in Section 54 (now 52). xxx xxx'. (***Underscoring supplied***).

10. For failure of petitioner to withhold the corresponding 15% withholding tax due on the interest payments made by it on its foreign loans/bills payable and to file the return therefor, the imposition of the 50% fraud penalty is valid and in order, the same being in accordance with Section 52(e) of the Tax Code, as amended;

11. Corollarily, for failure of petitioner to file the required return on the subject withholding tax as required under Section 51(e)(2), within the period required by law, prescriptive period for respondent Commissioner to assess petitioner is ten (10) years from the date of the discovery of such omission to file the return, pursuant to Section 269 (now 223) of the Tax Code, as amended which provides:

> `**Section 269**. Exception 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 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 any time within ten years after the discovery of the falsity, fraud or omission: Provided, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or

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> criminal action for the collection thereof'.
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> xxx xxx xxx
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> Inasmuch as respondent's Revenue Enforcement Officer started conducting the tax investigation in this case only on November 11, 1987, the issuance of the assessment on January 9, 1990 against the petitioner was well within the prescriptive period provided for under the aforecited Section 269 of the Tax Code;
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> 12. The issuance of Warrants of Distraint and Levy was in accordance with the provision of Section 205 in relation to Section 207, both of the Tax Code, as amended;
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> 13. All presumptions are in favor of the correctness of the Assessment (Provincial Autobus Co., Inc. vs. Commissioner of Internal Revenue, G.R. No. L-1775, July 31, 1963, 8 SCRA 527), and the burden of proof is upon petitioner to prove otherwise".

On July 3, 1992, petitioner's counsel moved to consolidate CTA Case No. 4436 with CTA Case No. 4811. Since both cases involve the same parties and the same issues and there being no objection on the part of respondent, said motion was granted in open court. This order to consolidate was subsequently confirmed in a Resolution, dated September 24, 1992.

The issues presented before Us are as follows:

1. Are the additional payments on top of the principal obligation incurred by the petitioner to be paid to the supplier, interest on foreign loans subject to the 15% final withholding tax?;

2. Has the respondent's right to assess already prescribed? and

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3. Did the respondent err when it issued a warrant of distraint and levy pending resolution of the protest filed by petitioner?

As regards the first issue, petitioner introduces the idea that what they paid to Samsung are liquidated damages and not interest on a foreign loan. It insists that the obligation of the petitioner under the letters of credit does not fall under the definition of a foreign loan, to state:

> "***Section 2. Definition of foreign loan*** .- For purposes of these regulations, the term "foreign loan" shall refer to loan contracts, including all debt items, whether in kind or in cash, which are payable in foreign currency or in kind, entered into by a Philippine resident, corporate or otherwise, with a non-resident. These consist of loans of the Central Bank, the National Government and its instrumentalities, government corporations and financial institutions; loans of the private sector including trade credits (D/A and O/A), which are normally renewable and other revolving credit arrangements. Therefore, foreign loans shall include the purchase of goods and services on credit by a Philippine resident from a non-resident either under deferred payment terms or on installment. xxx" (Rev. Regs. 4-75, July 22, 1975).

We do not agree.

Section 53 (e) (2) of the 1985 Tax Code clearly provides as follows:

> **(2) Non-resident foreign corporations.** - In the case of foreign corporations subject to tax under this Title, not engaged in trade or business within the Philippines, there shall be deducted and withheld at the source in the same manner and upon the same items as provided in subsection (b) (1) of this

> section, as well as on remunerations for technical services or otherwise, a tax equal to thirty-five **per centum** (35%) thereof: **Provided**, That interest on foreign loans shall be subject to withholding tax of fifteen **per centum** (15%). This tax shall be returned and paid in the same manner and subject to the same conditions as provided in Section 54. This deduction and withholding shall not be required in the case of reinsurance premiums ceded to foreign insurance corporations not engaged in trade or business in the Philippines.

It is clear from the aforequoted definition provided by Revenue Regulations No. 4-75 that what was obtained by FERMAP from Samsung is a foreign loan since a foreign loan covers purchase of goods on credit by a Philippine resident from a non-resident foreign corporation either under deferred payment terms or on installment. If paid on time, FERMAP pays no interest, but because of the delay in payment brought about by the CB Circular and which resulted in the restructuring of the loan, FERMAP was charged with a corresponding interest. The letters of credit upon which the petitioner issued the drafts in favor of Samsung were merely the means to obtain the loan.

Also, it is not correct to state that what was paid to Samsung are liquidated damages because as defined in Article 2226 of the Civil Code, liquidated damages are those agreed upon by the parties to a contract, to be paid in case of breach thereof. It is to be noted that when Samsung and FERMAP/petitioner agreed to pay

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interest, it was because of the breach that had already taken place. What was paid is in the nature of compensatory interest which is defined as interest given by way of damages (Civil Code, Paras, 1985 Ed., Vol. IV, p. 148). However, while what was paid is not liquidated damages, it is of the same token as compensatory interest since both compensate for damages caused. And since liquidated damages are taxable income to the extent that they represent compensation for lost profits (BIR Rulings dated September 8, 1954 and September 21, 1990, Bar Reviewer in Taxation, Nolledo, 1987 Ed., p. 187), it follows then that the interest that was paid in the instant case are likewise to be treated as taxable income and, therefore, subject to the 15% withholding tax.

Petitioner also contends that the right of respondent to assess and collect the taxes have already prescribed.

Again, we do not agree.

Nowhere in the records did we find any final withholding tax return supposedly filed by petitioner covering the subject assessments. Under Section 223 of the Tax Code, "(i)n the case of xxx 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 any time within ten years after the discovery of the xxx omission." Since prescription of the Government's right to assess taxes is an affirmative

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defense, it is incumbent on the taxpayer to prove that tax returns were actually filed so that the benefit of the three-year prescriptive period may be availed of (***Taligaman Lumber Co. v. Collector, 4 SCRA 842***).

But even assuming arguendo that a return was filed, still prescription had not set in. Since taxes withheld from interest on foreign loans are required to be paid within twenty-five (25) days from the close of each calendar quarter (Rev. Regs. 4-75), the assessment which was issued by respondent on January 27, 1989 in CTA Case No. 4436 involving petitioner's 1985 deficiency withholding tax was still within the three-year prescriptive period since the last day for the petitioner to file a return and pay the tax due was on January 25, 1986 which fell on a Saturday; hence, the last day is considered to be the next working day which is Monday, January 27, 1986. The same holds true in CTA Case No. 4811 involving petitioner's 1986 deficiency withholding tax where the assessment notice was issued on January 9, 1990, well within the prescribed three-year period counting from January 25, 1987, which is the last day of payment of the tax.

Finally, as to whether or not the respondent erred when it issued a Warrant of Distraint and Levy (CTA Case No. 4811) without resolving first petitioner's protest, We answer in the negative. This is not the first time that We have been confronted with such issue where We

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held that "the issuance of a warrant of distraint and levy to enforce collection of the deficiency assessment was tantamount to an outright denial of the request for reconsideration (*Vicente Hilado v. Commissioner of Internal Revenue*, CTA Case No. 1256, February 25, 1964). Further, the Supreme Court in the case of Commissioner of Internal Revenue vs. Algue, Inc., 158 SCRA 9, likewise ruled that:

> "It is true that as a rule the warrant of distraint and levy is "proof of the finality of the assessment" and "renders hopeless a request for reconsideration, being tantamount to an outright denial thereof and makes the said request deemed rejected."

However, while We rule against herein petitioner, this Court believes that the imposition of the 50% fraud penalty is not warranted. The mere failure of the petitioner to withhold the corresponding 15% withholding tax and to file the corresponding return does not of itself manifest fraud, considering the circumstances which caused petitioner's non-payment of the tax due. Petitioner failed to pay on time due to the Circulars issued by the Central Bank and it honestly believed that the interests it paid are liquidated damages which petitioner thought are non-taxable. Fraud is a serious charge and to be sustained, it must be supported by clear and convincing evidence (**Republic v. Ker & Co., Ltd., L-21609, Sept. 29, 1966**). Fraud being a question of fact

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must be alleged and proved (**Gutierrez v. CTA, L-9738; L-9771, May 31, 1957**).

WHEREFORE, in view of all the foregoing, petitioner is hereby **ORDERED** to **PAY** the respondent Commissioner of Internal Revenue the amounts of ₱507,595.14, inclusive of the 25% surcharge (CTA Case No. 4436) and ₱343,438.20, inclusive of the 25% surcharge (CTA Case No. 4811), plus 20% interest per annum from the date prescribed for payment until fully paid, pursuant to Section 249 (b) of the Tax Code, as amended.

No pronouncement as to costs.

SO ORDERED.

RAMON O. DE VEYRA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

AMANCIO Q. SAGA
Associate Judge

CERTIFICATION

I hereb 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

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