Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

SECOND DIVISION

UNITED COCONUT PLANTERS BANK, Petitioner,	**CTA Case No. 8963**
	Members: **CASTAÑEDA, JR.**, *Chairperson,* **CASANOVA,** *and* **MANAHAN,** *JJ.*
-versus-	
COMMISSIONER OF INTERNAL REVENUE, Respondent.	Promulgated: AUG 3 1 2017 4:30 p.m.

x---x

DECISION

CASANOVA, J.:

This is a Petition for Review[1], filed on January 5, 2015, by petitioner-United Coconut Planters Bank against respondent-Commissioner of Internal Revenue seeking the cancellation and setting aside of the Final Decision on Disputed Assessment (FDDA) dated December 1, 2014 issued by respondent against petitioner for the alleged deficiency income tax on earnings of its Foreign Currency Deposit Unit (FCDU) in the amount of ₱22,740,887.38 and gross receipts tax-FCDU in the amount of ₱10,173,252.18, inclusive of interest and penalty, for the taxable year 2006.

Petitioner is a domestic corporation duly organized and existing under Philippine laws, with principal office address at UCPB Building, Makati Avenue, 7907 Makati City. Its purpose is to operate under an expanded commercial banking authority; and by virtue thereof, to exercise the powers authorized for commercial banks, the powers of investment houses as provided in pertinent laws, and the authority to

---

[1] Docket (Vol. I), pp. 6-46.

invest in the equity of allied and non-allied undertakings in accordance with applicable laws, rules and regulations.[2]

Respondent is the duly appointed Commissioner of the Bureau of Internal Revenue (BIR) who has the power to decide disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties imposed in relation thereto or other matters arising under the National Internal Revenue Code (NIRC) or other laws or portions thereof administered by the BIR. He holds office at 5th Floor, BIR Building, Diliman, Quezon City.

On September 25, 2007, the BIR issued Letter of Authority (LOA) No. 00012336[3], authorizing the conduct of examination and audit of petitioner's books of accounts and accounting records for the period from January 1, 2006 to December 31, 2006.

On October 8, 2012, petitioner received a Notice for Informal Conference[4], inviting it for a conference to enable it to go over the BIR's findings and present its objections thereto, if any, as well as to submit whatever evidence it may have in its favor.

On October 22, 2012, petitioner responded[5] to the Notice for Informal Conference contesting the assessment for alleged deficiency taxes as stated in the notice. Thereafter, the BIR sent a revised initial assessment[6] to petitioner.

On January 30, 2013, petitioner received from the BIR a Preliminary Assessment Notice (PAN)[7], with Details of Discrepancy, assessing it for deficiency Income Tax-FCDU, Gross Receipts Tax-FCDU, Income Tax-RBU, Gross Receipts Tax-RBU, Final Tax on Interest Expense-RBU, Expanded Withholding Tax, Withholding Tax on Compensation, Fringe Benefits Tax and Documentary Stamp Tax-RBU and FCDU in the aggregate amount of ₱3,454,694,356.29, inclusive of interest.[8]

---

[2] Exhibit "P-1".
[3] Exhibit "P-2".
[4] Exhibit "P-3".
[5] Exhibit "P-4".
[6] Exhibit "P-5".
[7] Exhibits "P-7" and "P-7-a".
[8] Par. 1.4, Joint Stipulation of Facts and Issues (JSFI), Docket (Vol. II), p. 1151.

On March 6, 2013, petitioner received the Final Assessment Notice (FAN) with Details of Discrepancy[9] dated March 4, 2013, assessing it of deficiency taxes in the aggregate amount of ₱3,454,694,356.29, inclusive of interest and penalties.[10]

On March 26, 2013, petitioner filed a request for reinvestigation of the FAN dated March 4, 2013[11] and, on September 2, 2014, it filed with the BIR its Position Paper on the Revised Assessment for the Alleged Deficiency Income Tax, Gross Receipts Tax, Final Tax, Expanded Withholding Tax and Documentary Stamp Tax for taxable year 2006[12].

On December 2, 2014, petitioner received the FDDA with Details of Discrepancies[13], dated December 1, 2014, assessing it for deficiency Income Tax-FCDU, Gross Receipts Tax-FCDU, Final Withholding Tax on Interest Expense, Expanded Withholding Tax, Fringe Benefit Tax and Documentary Stamp Tax in the aggregate amount of ₱53,551,167.82.[14]

Petitioner filed the present Petition for Review on January 5, 2015 while respondent filed his Answer[15] thereto on March 23, 2015, interposing the following Special and Affirmative Defenses:

"xxx xxx xxx

SPECIAL AND AFFIRMATIVE DEFENSES

5. She reiterates and re-pleads the preceding paragraphs of this Answer as part of her Special and Affirmative Defenses.

6. Respondent observed both procedural and substantial due process in issuing the assessment subject of this case; the deficiency assessments for Income Tax and Gross Receipts Tax as well as Compromise Penalties were issued in accordance with law, rules and jurisprudence.

---

[9] Exhibits "P-8" and "P-8-a".
[10] Par. 1.5, JSFI, Docket (Vol. II), pp. 1151-1152.
[11] Exhibit "P-9".
[12] Exhibit "P-10".
[13] Exhibit "P-11".
[14] Par. 1.6, JSFI, Docket (Vol. II), p. 1152.
[15] Docket (Vol. I), pp. 436-445.

6.1 Petitioner's allegation that the FAN is null and void considering that it was issued beyond the prescriptive period provided under Section 203, in relation to Section 222 (b) of the NIRC of 1997 has no basis in fact and law.

6.2 On the contrary, a Waiver of the Defense of Prescription Under the Statute of Limitations of the National Internal Revenue Code was executed extending the period to assess petitioner until 31 December 2013.

6.3 Assuming that the Formal Letter of Demand/Final Assessment Notice dated 04 March 2013 was supposedly received on 06 March 2013, the aforesaid assessment was clearly received before 31 December 2013.

6.4 Thus, the period of respondent to assess petitioner for deficiency income and gross receipts tax did not lapse.

6.5 It should also be noted that petitioner signed a total of seven (7) waivers which were signed and accepted by both parties.

7. Petitioner was also informed of the factual and legal basis of the assessment. The Preliminary Assessment Notice, Formal Letter of Demand/Final Assessment Notice and Final Decision on Disputed Assessment indicated not only the deficiency taxes involved, compromise penalties and interest due thereon, but also sufficiently stated the facts, the law, rules and regulations on which the assessment is based.

8. The Revenue Officers performed a comprehensive audit procedure taking into account relevant documents. Consequently, petitioner is liable to pay deficiency Income Tax and Gross Receipts Tax as well as Compromise Penalties for taxable year 2006. The following is a summary of the findings of the revenue examiner as a result of the investigation conducted, to wit :

I. INCOME TAX(FCDU)	
Onshore-interest income:	
Interest income (Schedule 1)	P 233,409,063.39
Add Other income	0.00
Total onshore-interest income	P 233,409,063.39
Onshore-other income:	
Other income (Schedule 2)	P 61,667,417.79
General and administrative expense	(1,338,787.26)
Allocated expenses from RBU	0.00
Total onshore-other income	P 60,328,630.53
Income tax due per audit:	
Onshore-interest income (10%)	P 23,340,906.34
Onshore-other income (35%)	21,115,020.69
Total income tax due per audit	44,455,927.03
Less Income tax paid per return	35,557,334.40
BASIC DEFICIENCY INCOME TAX (FCDU)	8,898,592.63
Add Interest from 16-Apr-07 to 15-Dec-14 (2800 days=1.55556)	13,842,294.75
TOTA DEFICIENCY INCOME TAX (FCDU)	P 22,740,887.38

II. GROSS RECEIPTS TAX (FCDU)		
Taxable receipts subject to GRT (Schedule 3)		P 61,667,617.79
Gross receipts tax due:		
Service charges, fees and commissions-5%		P 1,889,857.53
Trading gain-7%		11,231.51
Miscellaneous-7%		1,659,701.20
Total gross receipts tax due		3,560,790.24
Less GRT paid per return		0.00
BASIC DEFICIENCY GROSS RECEIPTS TAX(FCDU)		3,560,790.24
Add Increments:		
Surcharge	P890,197.56	
Interest from 26-Jan 07 to 15-Dec.-2014 (2,880 days=1.60000)	5,697,264.38	
Compromise Penalty	25,000.00	6,612,461.94
TOTAL DEFICIENCY GROSS RECEIPTS TAX(FCDU)		P10,173,252.18

9. To reiterate, the assessments issued against petitioner must stand as supported by the following factual and legal bases stated in the Details of Discrepancies (attached to the Final Decision on Disputed Assessment), reiterated and incorporated herein, to wit:

I. INCOME TAX(FCDU)

- **Onshore Interest Income**. Onshore interest income of UCPB's FCDU which is subject to income tax under Section 27 (D)(3) of the Tax Code as amended by RA 9294 consist of the following:

Schedule 1-Onshore interest income

Interest income	P217,254,687.50
Add Adjustment (admitted by UCPB)	16,154,375.89
Total interest income per audit	P233,409,063.39

- **Onshore Other Income**. Onshore other income of UCPB's FCDU consists of the following:

Schedule 2-Onshore other income

Service fees and commissions	P37,796,950.56
Forex Gain (actual)	160,450.13
Miscellaneous income	23,710,017.10
Total	P61,667,417.79

The onshore other income is subjected herein to regular corporate income tax under Section 27(A) of the Tax Code as amended since these revenues could not be considered as "fees, commission and charges **integral** to **foreign loan** transactions of FCDUs" exempt from all taxes as provided for under RR 10-76.

- **Allocated Expenses from RBU**. General and administrative expenses allocated by the company's RBU to its FCDU operation pursuant to Section 50 of the Tax Code and Section 4(a)(3) of RR 10-76 amounting to P 724,662,667.00 was **not included** in the computation of taxable income subject to regular corporate income tax. It was noted that no claim for deduction was made by UCPB per its FCDU income tax return and it is only after the conduct of the Bureau's audit did UCPB claim that it is entitled to deductible expenses allocated by its RBU. Section 6(A) of the Tax Code prohibits amending the return once a '*notice for audit or investigation of such return, statement or declaration has in the meantime been actually served upon the taxpayer.*'

II. GROSS RECEIPTS TAX (FCDU)

- Taxable receipts. Onshore receipts of the bank's FCDU not covered by 10% Final withholding tax under Section 27 (D)(3) of the Tax Code is subject to Gross Receipt Tax ("GRT") provided for under Section 121 of the same Code. Revenues subject to GRT is computed as follows:

Schedule 3-Taxable receipts subject to GRT

	Tax Base	GRT due
Service charges, fees and commissions	P37,797,150.56	P1,889,857.53
Trading gain (actual)	160,450.13	11,231.51
Miscellaneous	23,710,017.10	1,659,701.20
Total receipts subject to GRT	P61,667,617.79	P3,560,790.24

9.1 **Difference in interest income – P9,886,377.00.** The discrepancy is due to the fact that per return, interest income of P

217,254,687.51 is based on the taxpayer's books whereas per FAN, interest income used by the Bureau amounting to P 227,141,064.51 is based on the amount as indicated in submitted CWT certificates.

Per verification, it was established that the actual onshore interest income is as shown in the taxpayer's books of P 217,254,687.50. The amount per CWT certificates includes part of the adjustments as shown on the second item ('Adjustment admitted by UCPB'). The taxpayer showed that the 2nd item actually consist of interest income from offshore sources which upon investigation should be classified as onshore, computed as follows:

Interest income with CWT certificate but shown per return as part of offshore income	9,886,377.00
Other offshore interest income deemed as onshore Income per investigation	6,267,998.89
Total adjustment	16,154,375.89

Thus, to use the amount of P 227,141,064.51 as interest income would mean that the adjustment of P 9,886,377.00 would be included in both 'Interest Income' and 'Adjustment admitted by UCPB'. Hence, to avoid double take up of subject adjustment in the computation of deficiency FCDU income tax, the amount of onshore interest income figure used is that shown per books of P 217,254,687.50.

9.2 **Adjustment admitted by UCPB- P16,154,375.89.** As discussed above, this item pertains to interest income originally classified as offshore income exempt from income tax by UCPB. Upon investigation, it was determined to be actually onshore income subject to 10% final withholding tax under Section27 (D)(3) of the NIRC.

9.3 **Reclass of other revenue items.** These are other incomes which are included as part of onshore interest income per return and includes 1) Discount/fees/commissions; 2) Foreign exchange profit/loss; 3) Other earnings. These items were re-classified as other onshore income subject to regular corporate income tax rate of 35%.

Anent service charges, fees and commissions; since it is classified, even in the taxpayer's return, as an onshore income, it follows that the related loan thereof is not 'foreign loan transactions' of UCPB's FCDU.

For 'Foreign exchange profit/loss'; verification disclosed that this account is actually composed of the following:

Net foreign exchange translation gain	86,261,895.54
Net interbank foreign exchange loss	(9,610,754.22)
Foreign exchange gain-actual	160,450.13
Total Foreign exchange profit/loss	76,811,681.45

The 'Net foreign exchange translation gain' pertains to net gain recognized by the bank in converting dollar denominated assets and liabilities to Philippine peso for audited financial statements presentation purposes. This item is therefore just a provision and is not considered as actual gain from a completed transaction. The 'Net interbank foreign exchange loss' is related to transactions with foreign banks, OBU's and other commercial banks under the foreign currency deposit system. Considering the said facts, the 1) forex gain from translation and 2) interbank forex loss are excluded from the computation of other onshore income of UCPB's FCDU.

9.4 **Gross receipts tax (FCDU)-P10,084,232.43.** For the year under audit, the subject taxpayer did not file any percentage tax return or GRT return for its FCDU operation. As discussed above, 'other onshore income' was treated by subject taxpayer as part of 'onshore interest income' which is subject to a preferential tax rate of 10% in lieu of all other taxes, hence, not subject to gross receipts tax (GRT). Upon investigation, however, it was established that these income are actually 'other onshore income' subject to RCIT of 35% and likewise to gross receipts tax as provided for under Section 121 of the Tax Code as amended.

A reading of Section 28 of the NIRC, as amended by Republic Act No. 8424 shows that the exemption of an FCDU's income from all taxes, including GRT, shall only apply if:

1. The income is from a foreign currency transactions; and
2. Said income is derived from transactions with a non-resident, another OBU or FCDU.

In the instant case, FCDU onshore income derived from residents are not exempt from tax, including GRT. In the case of the subject taxpayer, 1) service charges, fees and commissions; 2) trading gain; and 3) miscellaneous income are onshore income derived from residents, hence taxable for GRT purposes.

10. Respondent posits that, assessments are presumed correct and made in good faith. The taxpayer has the duty of proving otherwise. In the absence of proof of any irregularities in the performance of official duties, an assessment will not be disturbed. Even an assessment based on estimated *(sic)* is *prima facie* valid and lawful where it does not appear to have been arrived at arbitrarily or capriciously. **(Marcos II vs. Court of Appeals G.R. No. 120880 June 5, 1997)**

11. The burden of proof is on the taxpayer contesting the validity or correctness of an assessment to prove not only that the Commissioner of Internal Revenue is wrong but the taxpayer is right. Otherwise the presumption of correctness of tax assessment stands **(Commissioner of Internal Revenue vs. Hantex Trading Co.Inc, G.R No. 136975, March 31, 2005).** The presumption in favor of the correctness of tax assessment stands where evidence to the

contrary is wanting. Hence, the assessment issued against petitioner is imbued with factual and legal bases.

12. All presumptions are in favor of the correctness of tax assessments *(Sy Po vs. Court of tax Appeals, 164 SCRA 524).* Dereliction on the part of petitioner to satisfactorily overcome the presumption of regularity and correctness of the assessment will justify the judicial upholding of said assessment notice.

13. As decreed by the Honorable Supreme Court:

> 'Tax assessments by tax examiners are presumed correct and made in good faith. The taxpayer has the duty to prove otherwise. In the absence of proof of any irregularities in the performance of duties, an assessment duly made by a Bureau of Internal Revenue examiner and approved by his superior officers will not be disturbed. All presumptions are in favor of the correctness of tax assessments."

The case was set[16] for Pre-Trial Conference on April 30, 2015. Respondent's Pre-Trial Brief[17] was filed on April 23, 2015, and petitioner filed its Pre-Trial Brief[18] on April 27, 2015. The parties filed their Joint Stipulation of Facts & Issues[19] on June 3, 2015 which was approved by the Court in the Pre-Trial Order[20] dated June 15, 2015.

During trial, petitioner presented documentary and testimonial evidence to support its claims, and witnesses: (1) Ms. Cynthia A. Almirez[21]; (2) Ms. Jennifer Anne C. Cabral[22] and (3) Ms. Margarita Maria A. Nacpil.[23]

---

[16] Notice of Pre-Trial Conference, Docket (Vol. I), pp. 446-447.
[17] Docket (Vol. I), pp. 448-457.
[18] Docket (Vol. II), pp. 480-495.
[19] Ibid, pp. 1150-1163.
[20] Id., pp. 1166-1174.
[21] Minutes of the hearing on June 17, 2015, Docket (Vol. II), p. 1175.
[22] Minutes of the hearing on July 13, 2015 and January 20, 2016, Docket (Vol. III), pp. 1210 and p. 1530, respectively.
[23] Minutes of the hearing on July 13, 2015, Docket (Vol. III), p. 1210.

Thereafter, petitioner filed its Formal Offer of Documentary Exhibits[24] on September 24, 2015. Respondent filed his Comment (Re: Formal Offer of Documentary Exhibits)[25] on October 1, 2015.

In the Resolution[26] dated November 2, 2015, the Court admitted petitioner's exhibits, except Exhibits "P-6", "P-11-a", "P-11-b", "P-11-c, "P-11-d", "P-11-e", "P-11-f" and "P-16-1-a".

Petitioner filed a Motion for Partial Reconsideration (of the Resolution dated 2 November 2015) with Motion to Submit Supplemental Judicial Affidavit[27] on November 23, 2015. On January 25, 2016, petitioner filed, through registered mail, its Supplemental Formal Offer of Documentary Exhibits[28], offering Exhibits "P-21", "P-21-a", "P-11-a", "P-11-b", "P-11-c", "P-11-d", "P-11-e", "P-11-f" and "P-16-a". Respondent filed his Comment (Re: Supplemental Formal Offer of Documentary Exhibits)[29] on February 5, 2016.

In the Resolution[30] dated March 1, 2016, the Court admitted Exhibits "P-11-a", "P-11-b", "P-11-c", "P-11-d", "P-11-e", "P-11-f", "P-16-a", "P-21" and "P-21-a".

On the other hand, respondent presented the following witnesses: (1) Ms. Alpha Betty L. Tanguilig[31] and (2) Revenue Officer Matias D. Fadri III.[32]

On May 5, 2016, respondent filed his Formal Offer of Documentary Evidence[33]. Petitioner filed through registered mail its Comment To Respondent's Formal Offer of Documentary Evidence[34] on May 23, 2016 and received by the Court on June 2, 2016.

In the Resolution[35] dated July 21, 2016, the Court admitted all exhibits formally offered by respondent.

---

[24] Docket (Vol. III), pp. 1229-1237.
[25] Ibid, pp. 1451-1454.
[26] Id., pp. 1458-1459.
[27] Id., pp. 1460-1469.
[28] Id., pp. 1532-1539.
[29] Id., pp. 1563-1566.
[30] Id., pp. 1568-1569.
[31] Minutes of the hearing on March 30, 2016, Id., p. 1570.
[32] Minutes of the hearing on April 25, 2016, Id., p. 1571.
[33] Id., pp. 1580-1591.
[34] Id., pp. 1597-1602.
[35] Id., pp. 1606-1607.

Petitioner filed its Memorandum[36] on August 24, 2016. Respondent, however, manifested that he is adopting his Answer dated March 18, 2015 as his Memorandum[37], and the case was submitted for decision per Resolution[38] dated August 31, 2016.

The parties submitted the sole issue [39] for the Court's resolution:

> Whether petitioner is liable to pay deficiency Income Tax, Gross Receipts Tax and Compromise Penalty for taxable year 2006 in the aggregate amount of ₱32,914,139.56 as well as deficiency and delinquency interest as provided in Sections 248 and 249 of the NIRC.

Section 228 of the NIRC of 1997, as amended, governs the periods in filing an administrative protest, as follows:

> SEC. 228. Protesting of Assessment. - When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings xxx
>
> xxx xxx xxx
>
> Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment in such form and manner as may be prescribed by implementing rules and regulations. Within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final.
>
> If the protest is denied in whole or in part, or is not acted upon within one hundred eighty (180) days from submission of documents, the taxpayer adversely affected by the decision or inaction may

---

[36] Id., pp. 1608-1653.
[37] Respondent's Manifestation filed on August 25, 2016, Id., pp. 1655-1658.
[38] Resolution dated August 31, 2016, Id., p. 1659.
[39] JSFI, Docket (Vol. II), p. 1152.

> appeal to the Court of Tax Appeals within thirty (30) days from receipt of the said decision, or from the lapse of one hundred eighty (180)-day period; otherwise, the decision shall become final, executory and demandable.

Pursuant to Section 228 of the NIRC of 1997, petitioner has thirty (30) days from receipt of the FAN within which to file its administrative protest and another thirty (30) days from receipt of the respondent's decision, or from the lapse of one hundred eighty (180)-day period within which to file its Petition for Review with the Court.

In this case, petitioner received the FAN with Details of Discrepancies on March 6, 2013, assessing it of deficiency taxes in the aggregate amount of ₱3,454,694,356.29, inclusive of interest and penalties. Petitioner had thirty (30) days from March 6, 2013 or until April 5, 2013 within which to file its administrative protest with the respondent. It must be stressed that petitioner filed a request for reinvestigation on the FAN on March 26, 2013.

On December 2, 2014, petitioner received the FDDA assessing it of deficiency Income Tax-FCDU, Gross Receipts Tax-FCDU, Final Withholding Tax on Interest Expense, Expanded Withholding Tax, Fringe Benefit Tax and Documentary Stamp Tax in the aggregate amount of ₱53,551,167.82. Counting thirty (30) days from December 2, 2014, petitioner had until January 5, 2015[40] within which to file its Petition for Review with the Court. Hence, the Petition for Review filed by petitioner on January 5, 2015 was clearly within the thirty (30)-day prescriptive period.

The Court shall now determine the propriety of the deficiency tax assessments against petitioner.

On December 2, 2014, petitioner received from respondent the FDDA dated December 1, 2014 assessing it of various deficiency taxes in the aggregate amount of ₱53,551,167.81, broken down as follows:

---

[40] January 1, 2015 is a regular holiday while January 2, 2015 is a special non-working holiday. January 3 and 4, 2015 fell on Saturday and Sunday, respectively.

Type of tax	Basic Tax	Surcharge	Interest	Compromise Penalty	Total
Income Tax (FCDU)	₱8,898,592.63		₱13,842,294.75		₱ 22,740,887.38
Gross Receipts Tax (FCDU)	3,560,790.24	₱890,197.56	5,697,264.38	₱ 25,000.00	10,173,252.18
FWT on Interest	389,380.97		626,253.10		1,015,634.07
EWT	2,593,371.01		4,170,996.41		6,764,367.4[2]
FBT	136,190.57		219,039.38		355,229.95
DST	4,787,924.22		7,713,872.59		12,501,796.81
Total					₱ 53,551,167.8[1]

On December 5, 2014, petitioner paid the assessed deficiency FWT on interest[41], EWT[42], FBT[43] and DST[44], inclusive of interests, leaving the assessments on income tax-FCDU of ₱22,740,887.38 and gross receipts tax (GRT)-FCDU of ₱10,173,252.18, which are now the subject of the present case.

A. Income Tax-FCDU (₱22,740,887.38)

Respondent's examiner computed the deficiency income tax-FCDU in the amount of ₱22,740,887.38 as follows:[45]

Onshore-interest income:	
Interest income (Schedule 1)	₱ 233,409,063.39
Add Other income	0.00
Total onshore-interest income	**₱ 233,409,063.39**
Onshore-other income:	
Other income (Schedule 2)	₱ 61,667,417.79
General and administrative expense	(1,338,787.26)
Allocated expenses from RBU	0.00
Total onshore-other income	**₱ 60,328,630.53**
Income tax due per audit:	
Onshore-interest income (10%)	₱ 23,340,906.34
Onshore-other income (35%)	21,115,020.69
Total income tax due per audit	₱ 44,455,927.03
Less Income tax paid per return	35,557,334.40
Basic deficiency income tax (FCDU)	**₱ 8,898,592.63**
Add Interest from 16-Apr-07 to 15-Dec-14 (2,800 days = 1.55556	13,842,294.75
Total deficiency income tax (FCDU)	**₱ 22,740,887.38**

[41] Exhibit "P-12".
[42] Exhibit "P-13".
[43] Exhibit "P-14".
[44] Exhibit "P-15".
[45] Exhibit "P-11".

As can be gleaned from above, the assessed deficiency income tax was based on the interest income and other income (net of expense) of petitioner on its FCDU, in the amounts of ₱233,409,063.39 and ₱60,328,630.53, respectively.

Since petitioner did not anymore refute the assessed deficiency on onshore-interest income amounting to ₱23,340,906.34, the same shall be upheld. Hence, only the other income on the subject assessment is left for further discussion.

Based on the Details of Discrepancy attached to the FDDA[46], respondent subjected the onshore-other income to regular corporate income tax (RCIT) under Section 27(A) of the NIRC of 1997, as amended. These revenues could not be considered as 'fees, commission and charges **integral to foreign loan** transactions of FCDUs' exempt from all taxes as provided under RR 10-76. The onshore-other income of ₱61,667,417.79 consists of the following:

Service fees and commissions	₱ 37,796,950.56
Forex gain (actual)	160,450.13
Miscellaneous income	23,710,017.10
Total	**₱ 61,667,417.79**

Notably, the total service fees and commissions computed per the records[47] of the case amount to ₱37,797,150.56, but, since respondent assessed petitioner only in the amount of ₱37,796,950.56 in the FDDA, the same shall not be disturbed.

According to petitioner, its FCDU onshore-other income is mainly from service fees, commission and other charges imposed on foreign currency loan transactions with residents in the Philippines. Petitioner posits that, on the basis of existing tax laws and regulations, its FCDU onshore-other income consisting of service fees, commissions and other charges, which are integral parts of the charges imposed on foreign currency loan transactions with residents, is exempt from all taxes, thus, not subject to RCIT.

---

[46] Exhibit "P-11".
[47] BIR Records, Folder 5, pp. 2036, 2048.

In resolving the issue of whether the onshore-other income derived by FCDUs is exempt from all taxes, the Court finds it necessary to look at the historical background of the taxation of FCDUs.

Prior to the amendments introduced in the NIRC of 1997, as amended by RA 9337, Section 24(e)(3) of the 1977 Tax Code states that:

> "SECTION 24[48]. *Rates of tax on domestic corporations.* –
>
> xxx xxx xxx
>
> "(e) *Tax on certain incomes derived by domestic corporations.* –
>
> xxx xxx xxx
>
> "(3) *Tax on income derived under the Expanded Foreign Currency Deposit System.* – Income derived by a depository bank under the expanded foreign currency deposit system from foreign currency transactions with non-residents, off-shore banking units in the Philippines, local commercial banks including branches of foreign banks that may be authorized by the Central Bank to transact business with foreign currency depository system units and other depository banks under the expanded foreign currency deposit system **shall be exempt from all taxes**, except taxable income from such transactions as may be specified by the Minister of Finance, upon recommendation of the Monetary Board to be subject to the usual income tax payable by banks: *Provided,* That interest income from foreign currency loans granted by such depository banks under said expanded system to residents (other than offshore banking units in the Philippines or other depository banks under the expanded system) shall be subject to a 10% tax." *(Emphasis supplied)*

Relative thereto, the pertinent provisions of RR 10-76[49], as amended by RR 14-77, provide:

---

[48] As amended by Executive Order No. 37, July 31, 1986.

[49] Regulations governing taxation of Offshore Banks and Foreign Currency Deposit Units of depository banks established under P.D. 1034 and 1035, respectively.

"SECTION. 2(h). Gross onshore income shall mean gross interest income arising from foreign currency loans and advances to and/or investments with residents made by offshore banking units or expanded foreign currency deposit units. In case of foreign currency loan transactions, such **gross interest income shall refer only to the stipulated interest and shall not include any and all fees, commissions and other charges which are integral parts of the income from the above transactions**."

'SECTION 3. Rates of income tax to be imposed.—

'The rates of income tax to be imposed, which shall be in lieu of all other taxes such as, but not limited to privilege tax, gross receipt tax, documentary and science stamp tax and profit remittance tax, are as follows:

'(a) On offshore income, xxx.

'(b) In the case of gross onshore income as defined in Section 2(h) above, the tax shall be ten percent (10%) thereof and shall be a final tax. **Any and all fees, commissions and other charges which are integral parts of the charges imposed on foreign currency loan transactions are exempt from the tax herein imposed**.

'(c) **Income not covered by paragraphs (a) and (b) above shall be subject to the usual corporate taxes** imposed by National Internal revenue Code, as amended." *(Emphasis supplied)*

Clearly, under the 1977 Tax Code, as implemented by RR 10-76, and amended by RR 14-77, income earned by FCDU other than offshore income and gross onshore interest income (excluding fees, commissions and other charges integral thereto) shall be subject to the RCIT imposed under the Tax Code.

Revenue Audit Memorandum Order (RAMO) No. 1-84[50], clarifies the proper treatment of fees, commissions and other charges which

[50] Tax Treatment of Certain Items of Income Received by OBUs and FCDUs

are integral parts of the onshore interest income derived by OBUs and FCDUs from foreign currency loan transactions, to wit:

> "3. *Treatment of the Excluded or Exempt Gross Onshore Income*
>
> '3.1 The exclusion from gross onshore income (which is subject to the 10% final withholding tax) of the said 'fees, commissions, and other charges which are integral parts of the interest income' derived by an OBU or FCDU from foreign currency loan transactions does not justify their treatment as net income taxable under Section 24(a) of the Tax Code which imposes the normal income tax on net income at the rate of 25%-35%. In a memorandum to the Minister of Finance dated November 11, 1977, the Acting Commissioner of Internal Revenue in explaining the reason for amending Revenue Regulations No. 10-76 by Revenue Regulations No. 14-77, stated:
>
> > 'We have, after due deliberation, opted *to exempt from all taxes*, commissions, and fees and other charges which form integral part of the charges imposed on foreign loan transactions as this would be more in consonance with our policy of favoring foreign currency transactions of OBUs and FCDUs.
>
> '3.2 Moreover, to treat the gross onshore income items which are expressly excluded for purposes of the 10% final withholding tax as taxable under Section 24(a) of the Tax Code will result in taxation of 'net income from such transactions as may be specified by the Minister of Finance, upon recommendation of the Monetary Board.' Considering that the Minister of Finance has not yet specified, much less the Monetary Board has not recommended, what items of net income derived by OBUs and FCDUs are 'subject to the usual income tax payable by banks,' the said commissions and fees and other charges which were excluded by Sections 2(h) and 3(b) of Revenue Regulations No. 10-76, as amended by Revenue Regulations No. 14-77, are exempt from all taxes, including the normal corporate income tax of 25%-35% payable by banks."

With the introduction of Section 27(D)(3) of the NIRC of 1997[51], amending Section 24(e)(3) of the 1977 Tax Code, however, the phrase "exempt from all taxes" was deleted. Said Section 27(D)(3) reads:

> "SEC. 27. *Rates of Income Tax on Domestic Corporations.* –
>
> xxx xxx xxx
>
> '(D) *Rates of Tax on Certain Passive Incomes.* –
>
> xxx xxx xxx
>
> '(3) *Tax on Income Derived under the Expanded Foreign Currency Deposit System.* – Income derived by a depository bank under the expanded foreign currency deposit system from foreign currency transactions with local commercial banks, including branches of foreign banks that may be authorized by the Bangko Sentral ng Pilipinas (BSP) to transact business with foreign currency depository system units and other depository banks under the expanded foreign currency deposit system, including interest income from foreign currency loans granted by such depository banks under said expanded foreign currency deposit system to residents, shall be subject to a final income tax at the rate of ten percent (10%) of such income."

Sections 2.27 and 2.28 of RR No. 10-98,[52] governing the imposition of income tax on income derived under the Foreign Currency Deposit and Offshore Banking Systems, categorically provide that:

> "(C) *Taxation of Income of an FCDU or OBU from Foreign Currency Transactions.* In general, income derived by an FCDU or an OBU from foreign currency transactions with residents of the Philippines, including

---

[51] Tax Reform Act of 1997 (National Internal Revenue Code) Republic Act No. 8424.

[52] Implementing the Provisions of the National Internal Revenue Code, As Amended By Republic Act No. 8424, Relative to the Imposition of Income Taxes on Income Derived Under the Foreign Currency Deposit and Offshore Banking Systems

local commercial banks, local branches of foreign banks, and other depository banks under the foreign currency deposit system, shall be subject to a final withholding tax of ten percent (10%) based on gross income pursuant to Section 27(D) (3) and Section 28 (A) (4) of the Code. Income from foreign currency transactions shall include interest income from lending operations, including bank charges, commissions, service fees, and net foreign exchange transaction gains."

By the clear import of the law, FCDUs no longer enjoyed the tax exemption under the 1977 Tax Code. By virtue of such deletion, therefore, RR No. 10-76, as amended by RR No. 14-77, which implemented the old law was no longer applicable and FCDUs became liable to pay tax on its income from foreign currency loans.

Subsequently, RA No. 9294 otherwise known as "An Act Restoring the Tax Exemption of Offshore Banking Units (OBUs) and Foreign Currency Deposit Units (FCDUs)", enacted on April 28, 2004, further amended Section of the NIRC of 1997, as follows:

"Sec. 27. *Rates of Income Tax on Domestic Corporations.* —

"(D) *Rates of Tax on Certain Passive Incomes.* —

"(3) *Tax on Income Derived under the Expanded Foreign Currency Deposit System.* — Income derived by a depository bank under the expanded foreign currency deposit system from foreign currency transactions with nonresidents, offshore banking units in the Philippines, local commercial banks including branches of foreign banks that may be authorized by the Bangko Sentral ng Pilipinas (BSP) to transact business with foreign currency deposit system **shall be exempt from all taxes**, except net income from such transactions as may be specified by the Secretary of Finance, upon recommendation by the Monetary Board to be subject to the regular income tax payable by banks: *Provided, however,* That interest income from foreign currency loans granted by such depository banks under said expanded system to residents other than offshore banking units in the Philippines or other depository banks under the expanded system shall be subject to a final tax at the rate of ten percent (10%)." *(Emphasis supplied)*

The same provision of Section 27(D)(3) of RA No. 9294 was then adopted under the NIRC of 1997, as amended by RA 9337.

With the foregoing amendment, the tax exemption enjoyed by FCDUs under the 1977 Tax Code was clearly restored. Likewise, the particular provisions of RR No. 10-76, as amended by RR No. 14-77, exempting FCDUs from taxes are, therefore, re-enforced.

Applying the foregoing to the instant case, it is clear that the forex gain of ₱160,450.13 and miscellaneous income of ₱23,710,017.10 earned by petitioner's FCDUs, which were not classified as offshore income or onshore interest income based on the definition under RR No. 10-76 and were not expressly exempt by any law from tax, shall be considered as other income subject to the RCIT of 35% pursuant to Section 27(A) of the Tax Code, as amended.

Anent the service charges, fees and commissions of ₱37,796,950.56, to be exempt from tax, the same should be integral parts of the gross interest income derived from foreign currency loan transactions with depository banks under the expanded system.

Petitioner, in this case, merely invoked the exemption of service fees and commissions under the aforementioned laws but did not prove that such income it earned were indeed integral parts of the gross interest income derived from its foreign currency loan transactions. Since petitioner is implying that its service fees and commissions of ₱37,796,950.56 are integral parts of the gross interest income derived from foreign currency loan transaction with residents, it is but incumbent upon him to prove the same. In as much as petitioner failed to clearly establish its claim, the service fees and commissions shall likewise be considered as other income subject to RCIT of 35% under Section 27(A) of the NIRC of 1997, as amended.

As exemptions are highly disfavored in law, he who claims exemptions must be able to justify his claim. Statutes granting tax exemptions must be construed in *strictissimi juris* against the taxpayer and liberally in favor of the taxing authority.[53] The burden of proof rests upon the party claiming exemption to prove that it is, in fact, covered by the exemption so claimed.[54] It is, therefore, the duty of petitioner, and not of respondent, to prove that the subject service charges, fees and commissions of ₱37,796,950.56 are, indeed, integral parts of the gross interest income derived from foreign currency loan transactions with depository banks under the expanded system to be exempt from tax.

Having determined that the onshore-other income shall be subject to RCIT, petitioner further contends that, the amount of ₱36,576,314.27 should be allowed as deduction from the gross onshore-other income to determine the taxable income subject to RCIT. The said amount is part of the ₱724,543,990.29 allocated from the total expenses of petitioner's Regular Banking Unit (RBU) as general and administrative expense for the operation of petitioner's FCDU pursuant to Section 50 of the NIRC of 1997 and Section 4 of RR No. 10-76.

On the other hand, respondent explained that the general and administrative expenses allocated by petitioner's RBU to its FCDU operation was not included in the computation of taxable income subject to RCIT since no claim for deduction was made by petitioner per its FCDU income tax return and it is only after the conduct of the audit did petitioner claim that it is entitled to such deductible expenses. Section 6(A) of the Tax Code prohibits amending the return once a notice for audit or investigation of such return has, in the meantime, been actually served upon the taxpayer.

The Court agrees with respondent.

Section 6(A) of the NIRC of 1997 provides that any return, statement or declaration filed may be modified, changed, or amended within three (3) years from the date of such filing, provided, that no notice for audit or investigation of such return, statement or declaration has, in the meantime, been actually served upon the taxpayer. Accordingly, petitioner is already precluded to amend its tax returns. And since petitioner did not claim any deduction for the

---

[53] *Commissioner of Internal Revenue vs. Isabela Cultural Corporation,* G.R. No. 172231, February 12, 2007, 515 SCRA 556.

[54] National Power Corporation vs Province of Isabela, G.R. No. 165827, June 16, 2006 citing Cyanamid Philippines, Inc. vs Court of Appeals, 379 Phil. 689, 703 (2000).

allocated expense from RBU in its Annual Income Tax Return-FCDU[55], it cannot enjoy a tax benefit therefrom. Consequently, the alleged allocated expense cannot be considered in computing the taxable income subject to 35% RCIT.

In sum, petitioner shall be held liable for basic deficiency income tax-FCDU in the amount of ₱8,898,592.63, as herein computed:

Onshore-interest income (₱233,409,063.39 x 10%)	₱ 23,340,906.34
Onshore-other income [(₱61,667,417.79 - ₱1,338,787.26) x 35%]	21,115,020.69
Total income tax due	₱ 44,455,927.03
Less Income tax paid per return	35,557,334.40
Basic deficiency income tax-FCDU due	**₱ 8,898,592.63**

B. GRT-FCDU (₱10,173,252.18)

The onshore receipts of the bank's FCDU not covered by the 10% final withholding tax under Section 27(D)(3) of the NIRC of 1997, as amended was subjected by respondent to gross receipt tax (GRT) in the amount of ₱10,173,252.18, inclusive of interest and penalty provided under Section 121 of the same Code, computed as follows:[56]

Service charges, fees and commissions		₱ 37,797,150.56
Trading gain (actual)		160,450.13
Miscellaneous		23,710,017.10
Total receipts subject to GRT		₱ 61,667,617.79
Gross receipts tax due:		
Service charges, fees and commissions - 5%		₱ 1,889,857.53
Trading gain - 7%		11,231.51
Miscellaneous - 7%		1,659,701.20
Total gross receipts tax due		₱ 3,560,790.24
Less: GRT paid per return		-
Basic deficiency GRT (FCDU)		**₱ 3,560,790.24**
Add Increments:		
Surcharge	₱ 890,197.56	
Interest from 26-Jan-07 to 15-Dec-14	5,697,264.38	
Compromise penalty	25,000.00	6,612,461.94
Total deficiency GRT		**₱10,173,252.18**

[55] BIR Records, Folder 5, pp. 1706-1711.
[56] Exhibit "P-11", Docket, vol. III, pp. 1406 and 1409-1410.

Apparently, the total receipts subjected by respondent to GRT are the same onshore-other income that are subject to RCIT as discussed in *item A.* above.

Petitioner maintains that based on legislative history of taxation of FCDUs, all fees, commissions and other charges which are integral components of the interest income derived by petitioner's FCDU from its foreign currency loan transactions with residents, are exempt from all taxes, including GRT.

Based on RR No. 10-76, as amended by RR No. 14-77, and RAMO No. 1-84, other income, not classified as offshore income or onshore interest income are subject to the usual corporate taxes payable by banks save for the service fees, commissions, and other charges integral to the gross interest income derived from foreign currency loan transaction with residents, which are exempt from all taxes.

As earlier discussed, the trading gain of ₱160,450.13 and miscellaneous income of ₱23,710,017.10 earned by petitioner's FCDUs, were not classified as offshore income or onshore interest income and were not expressly exempt by any law from tax. As such, said income shall be subject to the usual corporate taxes, including GRT imposed on banks under Section 121 of the NIRC of 1997, as amended, which states:

> "SEC. 121. *Tax on Banks and Nonbank Financial Intermediaries.* – There shall be a collected tax on gross receipts derived from sources within the Philippines by all banks and nonbank financial intermediaries in accordance with the following schedule:
>
> (a) On interest, commissions and discounts from lending activities as well as income from financial leasing, on the basis of remaining maturities of instruments from which such receipts are derived:
> Maturity period is five years or less 5%
> Maturity period is more than five years 1%
>
> (b) xxx
>
> (c) On royalties, rentals of property, real or personal, profits from exchange and all other items treated as gross income under Section 32 of this Code 5%

(d) On net trading gains within the taxable year on foreign currency, debt, securities, derivatives, and other similar financial instruments ....7%"

Pursuant thereto, the trading gain shall be subject to 7% GRT as correctly assessed by respondent. On the other hand, the miscellaneous income shall be subject to GRT rate of only 5%, it being other items treated as gross income under the same Code, as opposed to the 7% rate used by respondent.

Further, considering that petitioner failed to prove that its service fees and commissions are integral parts of the gross interest income derived from foreign currency loan transaction with residents, which are exempt from all taxes, the said income of petitioner's FCDU shall be subject to the imposed GRT on banks, as well. Since petitioner did not provide proof as basis to determine the maturities of the instruments related to the assessed service fees and commissions, respondent's imposition of 5% GRT shall not be disturbed, in line with the rule that tax assessments by tax examiners are presumed correct and made in good faith, unless proven otherwise.

Meanwhile, the compromise penalty of ₱25,000.00 imposed on the same assessed GRT shall be cancelled since there is no showing that petitioner consented to the same.

It must be stressed that, compromise penalty is imposed to avoid prosecution for violation of the provisions of the Tax Code.[57] Pursuant to Revenue Memorandum Order (RMO) No. 01-90, as amended by RMO No. 19-07, compromise penalties are only suggested in settlement of criminal liability, and may not be imposed or exacted on a taxpayer in the event that a taxpayer refuses to pay the same. Clearly, the compromise penalty implies a mutual agreement between the parties in respect to the thing or subject matter which is so compromised. The imposition of the same without the conformity of the taxpayer is illegal and unauthorized.[58]

In sum, petitioner is liable to pay basic deficiency GRT on its FCDU in the amount of ₱3,086,589.89, computed as follows:

---

[57] The Philippines International Fair, Inc. vs. The Collector of Internal Revenue, et. al., G.R. Nos. L-12928 and L-12932, March 31, 1962.
[58] Commissioner of Internal Revenue vs. Lianga Bay Logging Co., Inc. et. al., G.R. No. L-35266, January 21, 1991.

	Tax Base	GRT Due
Service charges, fees and commissions - 5%	₱ 37,797,150.56	₱ 1,889,857.53
Trading gain - 7%	160,450.13	11,231.51
Miscellaneous - 5%	23,710,017.10	1,185,500.86
Total Basic deficiency GRT (FCDU)		**₱ 3,086,589.89**

WHEREFORE, premises considered, the Petition for Review is **PARTIALLY GRANTED**. Accordingly, the assessment covering deficiency income tax-FCDU and GRT-FCDU for taxable year 2006 is upheld but in the modified amount of **₱14,981,478.15**, inclusive of 25% surcharge imposed under Section 248(A) of the NIRC of 1997, as amended, computed as follows:

Tax Type	Basic	Surcharge	Total
Income tax-FCDU	₱ 8,898,592.63	₱ 2,224,648.16	₱ 11,123,240.79
GRT-FCDU	3,086,589.89	771,647.47	3,858,237.36
Taxes still due	**₱11,985,182.52**	**₱2,996,295.63**	**₱14,981,478.15**

In addition, petitioner is liable to pay:

(a) deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency income tax-FCDU of ₱8,898,592.63 and GRT-FCDU of ₱3,086,589.89, computed from April 15, 2007 and January 25, 2007, respectively, until full payment thereof pursuant to Section 249(B) of the NIRC of 1997, as amended; and

(b) delinquency interest at the rate of 20% per annum on the total amount of ₱14,981,478.15 representing the total deficiency income tax-FCDU and GRT-FCDU and on the deficiency interest which have accrued as afore-stated in (a) computed from December 15, 2014 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997, as amended.

SO ORDERED.

CAESAR A. CASANOVA
Associate Justice

WE CONCUR:

JUANITO C. CASTAÑEDA, JR.
Associate Justice

CATHERINE T. MANAHAN
Associate Justice

ATTESTATION

I attest that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairperson, Second Division

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, and the Division Chairperson's Attestation, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court.

ROMAN G. DEL ROSARIO
Presiding Justice