REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

****

DEUTSCHE BANK AG MANILA BRANCH,
Petitioner,

C.T.A. Case No. 6566

Members:

- versus -

ACOSTA, *Chairman*
BAUTISTA, and
CASANOVA, *JJ.*

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

MAY 17 2005

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DECISION

***ACOSTA, E., PJ.*:**

This case seeks for the cancellation and withdrawal of the alleged deficiency onshore tax, plus compromise penalty and interest charges, in the total amount of **THIRTY NINE MILLION ONE HUNDRED ONE THOUSAND NINE HUNDRED SEVENTY SEVEN AND 49/100 PESOS (P39,101,977.49)** covering the taxable year ended December 31, 1998. (*Should be Six Million One Hundred Forty Seven Thousand Six Hundred Sixty Two and 50/100 Pesos– P6,147,662.50*)

Petitioner, Deutsche Bank AG-Manila Branch, a foreign corporation organized and existing under the laws of the Federal Republic of Germany, was granted by the Bangko Sentral ng Pilipinas (BSP) on July 3, 1995 a Certificate of Authority to operate a branch with full banking authority in the Philippines, pursuant to Monetary Board Resolution No. 98 dated January 31, 1995 and Republic Act No. 7221. Likewise, it was authorized by the Securities and Exchange Commission (SEC) to operate a branch office with full banking authority in the Philippines on July 12, 1995, pursuant to Republic Act (RA) No. 7221, as implemented under the Bangko Sentral ng Pilipinas (BSP) Circular No. 51. As such, License Number F-1228 was issued to petitioner on October 28, 1998 (*pars. 1-3, Joint Stipulation of Facts*).

On December 21, 2001, petitioner received a Preliminary Assessment Notice dated November 12, 2001, signed by the Assistant Commissioner of the Bureau of Internal Revenue Large Taxpayers' Service, Ms. Virginia L. Trinidad (*par. 5, Joint Stipulation of Facts*), informing petitioner of her assessment findings for deficiency taxes with breakdown as follows:

Kind of Deficiency Tax	Basic Tax	Interest	Total Amount due
Withholding Taxes			
a. Compensation	₱ 7,066,000.45	₱ 4,140,676.26	₱ 11,206,676.71
b. Expanded Withholding	630,502.01	369,474.18	999,976.19
c. Fringe Benefits Tax	551,781.10	388,707.31	940,488.41
Income Tax - Onshore Income	11,400,525.91	6,680,708.18	18,081,234.09
Gross Receipts Tax	1,605,223.40	940,660.91	2,545,884.31
Documentary Stamp Tax	3,341,518.93	1,986,198.85	5,327,717.78
Total	₱24,595,551.80	₱14,506,425.69	₱ 39,101,977.49

(Exhibit C)

On January 22, 2002, petitioner received a Formal Letter of Demand dated January 18, 2002 with the corresponding Assessment Notice No. 98-000031 dated January 8, 2002. Details as shown on the Formal Letter of Demand are as follows:

Kind of Deficiency Tax	Basic Tax	Interest	Compromise	Total Amount due
Income Tax on Onshore Income	₱ 11,400,525.91	₱ 6,869,956.91	₱ 25,000.00	₱ 18,295,482.82
Gross Receipts Tax	1,605,223.40	967,307.62	25,000.00	2,597,531.02
Withholding Tax				
a. Compensation	7,066,000.45	4,257,971.87	25,000.00	11,348,972.32
b. Expanded Withholding	630,502.01	379,940.51	20,000.00	1,030,442.52
Fringe Benefits Tax	551,781.10	397,866.88	20,000.00	969,647.98
Documentary Stamp Tax	3,341,518.93	2,041,668.06	25,000.00	5,408,186.99
Total	₱24,595,551.80	₱14,914,711.85	₱140,000.00	₱39,650,263.65

On January 31, 2002, petitioner, after evaluating the different tax issues, paid the amounts of Two Hundred Seventy Five Thousand Seven Hundred Eighty Eight and 94/100 Pesos (P275,788.94) as deficiency Expanded Withholding Tax and Three Hundred Thirty Thousand Two Hundred Ninety Two and 30/100 Pesos (P330,292.30) as deficiency Fringe Benefits Taxes for the taxable year ended December 31, 1998. Details of the tax payment are as follows:

Kind of Deficiency Tax	Basic Tax	Interest	Compromise	Total Amount due
Expanded Withholding	₱ 162,084.44	₱ 97,704.50	₱ 16,000.00	₱ 275,788.94
Fringe Benefits Tax	196,089.53	118,202.77	16,000.00	330,292.30
Total	₱358,173.97	₱215,907.27	₱ 32,000.00	₱606,081.24

(par. 7, Joint Stipulation of Facts)

With regard to the rest of the tax assessed, petitioner disputed the same by filing on February 21, 2002 its protest letter stating therein its arguments for the cancellation and or reconsideration of the formal letter of demand. Petitioner likewise submitted on April 18, 2002 all the supporting documents in compliance with the provisions of the law. *(Pars. 8 and 9, Joint Stipulation Of Facts)*

On October 18, 2002, petitioner received a letter from the then Assistant Commissioner of the Bureau of Internal Revenue Large Taxpayers' Service, Atty. Edwin R. Abella, informing petitioner of the results of its 1998 deficiency tax assessments as conducted by the respondent's Audit Investigation Division. A substantial modification of the assessment was made in such a way that the total amount due as deficiency onshore income tax, including interest up to September 30, 2002 and compromise penalties, was recomputed at **Six Million One Hundred Forty Seven Thousand Six Hundred Sixty Two and 50/100 Pesos (P6,147,662.50),** with breakdown as follows:

Kind of Deficiency Tax	Basic Tax	Interest up to September 30, 2002	Compromise	Total Amount Due
Income Tax on Onshore Income	₱3,527,285.69	₱2,597,376.81	₱25,000.00	₱6,149,662.50

In effect, the original assessments made against petitioner for deficiency withholding taxes on compensation, gross receipts tax, and documentary stamp taxes were all cancelled. The focal portion of the said letter provides:

> "After considering your side as presented in your position papers dated February 21, 2002 and April 18, 2002 and taking into account the additional documents presented in the reinvestigation, our position on the taxability of your On-shore Income stays while the rest of the issues raised in the Final Assessment Notice are withdrawn and shall be cancelled accordingly. At this point, we consider the on-shore tax one of the legal issues, hence, the case is being referred to our Legal Service for their resolution.
>
> x x x
>
> A final resolution of this case shall be served on you once the Legal Service clears all the legal issues."

Construing the above response as respondent's partial denial of its protest letter, petitioner, on November 14, 2002, filed this Petitioner for Review with this Court pursuant to Section 228 of the National Internal Revenue Code of 1997.

During the pendency of this action, petitioner submitted An Offer for Compromise Settlement without, however, admitting any of the facts and the legal issues as stated in its protest letter. Thus, in a letter dated December 12, 2002, pursuant to Section 204 (A) of the National Internal Revenue Code of 1997, petitioner offered the amount of P1,410,914.28 or approximately 40% of the basic deficiency income tax on its on-shore income after reinvestigation which is in the amount of P3,527,285.69. However, no affirmative action was undertaken by the respondent with regard to the offer.

On January 6, 2003, respondent filed his Answer raising the following as his Special and Affirmative Defenses, to wit:

3. Section 28 (A)(7)(b) of the Tax Code, as amended, provides the following:

> *"Sec. 28 (A) Tax on Resident Foreign Corporation*
>
> (7) *Tax on Certain Incomes Received by a Resident Foreign Corporation. –*
>
> (b) *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 and other depository banks under the expanded foreign currency deposit system, including interest income from foreign currency loans granted by such depository banks under the expanded foreign currency deposit system to residents, shall be subject to a final income tax at the rate of ten per cent (10%) of such income. xxx"

4. Sections 2.27 and 2.28 (C) of Revenue Regulations No. 10-98 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 provide the following:

> ***"Section 2.27 and 2.28 (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 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 per cent (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**. Xxx" (Emphasis supplied)

Hence, subject incomes which were in fact commissions and gains realized from buying and selling foreign currency from and to individual and corporate clients other than banks are taxable at 10%.

5. Revenue Regulations No. 10-98 did not alter, modify or amend the intent of the law. The intention of said revenue regulation, as clearly suggested by its title, is to cover the imposition of income taxes of income derived under the Foreign Currency Deposit and Offshore Banking System.

   With the accumulation of experience and growth of specialized capabilities by the agency charged with implementing a particular statute, it is now a settled principle that the construction given to a statute by an administrative agency charged with the interpretation and application of that statute is entitled to great respect and should be accorded great weight by the courts, unless such construction is clearly shown to be in sharp conflict with the governing statute or the constitution and other laws (*Nestle Philippines, Inc. vs. CA, et al. 203 SCRA 504*).

6. The Effectivity Clause, as well as the Transitory Provision of Revenue Regulations No. 10-98 which was dated August 25, 1998, is quoted hereunder to show that the retroactive application of said revenue regulation is valid, the same not being prejudicial to the taxpayers, viz:

> "EFFECTIVITY CLAUSE. These Regulations shall apply on taxable income derived beginning January 1, 1998 pursuant to the provisions of Section 8 of RA 8424. In case of deposits which were made in 1997, only that portion of interest which was actually or constructively received by a

> depositor starting January 1, 1998 is taxable.
>
> TRANSITORY PROVISION. No penalty shall be imposed for late payment of the tax herein prescribed for the first three quarters of calendar year 1998, provided, however, that the taxpayer's corresponding tax returns for the said taxable quarters are filed and taxes due are paid not later than October 25, 1998."

7. The assessment was issued in accordance with the existing law and regulations.

8. Assessments are *prima facie* 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. All presumptions are in favor of tax assessments (*Interprovincial Autobus Co., Inc. v. Collector of Internal Revenue, 98 Phil 290; Sy Po v CTA, et.al. GR No. 81446, August 18, 1988; Dayrit, et. al. v. Cruz, et. al., L-39910, September 26, 1988; Cagayan Robina Sugar Milling Company v. Court of Appeals, et. al. G.R. No. 122451, October 12, 2000*).

9. Exemption from taxation are highly disfavored in law, and he who claims exemption must be able to justify his claim by the clearest grant of organic or statute law. An exemption from the common burden cannot be permitted to exist upon vague implications (*Asiatic Petroleum Co. (P.I.) Ltd. v. Manila Jockey Club, Inc., 98 Phil 670; Davao Light & Power Co., Inc. v. Commissioner of Customs, et. al., L-23739 & L-28902, March 29, 1972*).

In a Resolution dated January 6, 2005, this case was considered submitted for decision after both parties have submitted their memoranda.

The issues as stipulated by the parties are as follows:

1. Whether or not the commissions and gains realized from buying and selling foreign currency from and to individual and corporate clients other than banks are taxable under Section 28 (A)(7)(b) of the Tax Code;

2. Whether or not the petitioner is liable to pay the aggregate amount of P6,147,662.50 as deficiency onshore income tax for taxable year 1998.

As the two issues presented are interrelated, this Court deems it proper to discuss them jointly.

Petitioner relies firmly on Section 28 (A)(7)(b) of the National Internal Revenue Code of 1997 for the non-taxability of the income reported in its Income Tax Return under the foreign currency deposit unit transactions. Petitioner argues that said income derived does not pertain to interest income from residents, but rather, to commissions and gains realized from buying and selling of foreign currency from individuals and corporate clients, other than banks.

Thus, it is petitioner's contention that pursuant to said Section 28 (A)(7)(b), only the following are expressly enumerated as being taxable at 10% final tax on the gross onshore income, to wit:

> (1) Income derived by a foreign currency depository unit (FCDU) from its foreign currency transactions with local commercial banks including branches of foreign banks and other depository banks under the expanded foreign currency deposit system; and
>
> (2) Interest income from foreign currency loans granted by such FCDU under the said expanded foreign currency deposit system to residents.

Accordingly, the commissions and gains derived from petitioner's buying of foreign currency from individual and corporate clients other than banks, and the selling of foreign currency to clients other than banks, are not included as subject to the ten per cent (10%) final tax under the said provision of the National Internal Revenue Code (NIRC) of 1997. Verily, these items are not taxable under Section 28 (A)(7)(b) of the 1997 NIRC.

Petitioner further avers that Sections 2.27 and 2.28 of Revenue Regulations No. 10-98 expanded the coverage of Section 28 (A)(7)(b) of the 1997 NIRC. Such is contrary to the basic doctrine laid down by the Honorable Supreme Court that a law cannot be expanded by rules issued to implement it. The rules and regulations must always be within the scope of the law which it seeks to implement. Petitioner cites the case of United States vs. Molina G.R. No. 9878, December 24, 1914 wherein the Honorable Supreme Court ruled that "the regulations adopted under legislative authority by a particular department must be in harmony with the provisions of the law, and for the sole purpose of carrying into effect its provisions. By such regulations, of course, the law itself cannot be extended."

On the other hand, respondent maintains that pursuant to Sections 2.27 and 2.28 of Revenue Regulations No. 10-98, in implementing the provisions of Section 28(A)(7)(b) of the 1997 National Internal Revenue Code, the commissions and gains realized by petitioner from the buying and selling of foreign currency from individuals and corporate clients other than banks, are subject to the ten per cent (10%) final tax. And, Revenue Regulations No. 10-98 did not alter, modify nor amend the intent of the law. The intention of the said revenue regulations, as clearly stated in its title, is to cover the imposition of taxes of income derived from the Foreign Currency Deposit and Offshore Banking System.

Furthermore, the Effectivity Clause and Transitory Provisions of said revenue regulations show that its retroactive application is valid, the same not being prejudicial to the taxpayers.

This Court does not agree with respondent's justifications.

Section 28 (A)(7)(b) of the 1997 National Internal Revenue Code specifically provides:

Section 28. Rates of Income Tax on Foreign Corporation. –

> (A) Tax on Resident Foreign Corporations. –
>
> xxx xxx xxx
>
> (7) Tax on Certain Incomes Received by a Resident Foreign Corporation. –
>
> **(b) 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 deposit 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 per cent (10%) of such income.
>
> Any income of nonresidents, whether individual or corporations, from transactions with depository banks under the expanded system shall be exempt from income tax.

From the above provision of law, the incomes subject to ten per cent (10%) final tax are the following:

1. **Income** derived by a domestic or resident foreign corporation which is 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; and

2. **Interest income** of such depository banks from foreign currency loans granted under the expanded foreign currency deposit system **to residents**.
(Emphasis supplied.)

Since the incomes of a depository bank subject to the 10% final tax under Section 28 (A)(7)(b) are only all income from foreign currency transactions with local, branches of foreign commercial banks, or other depository banks **and** interest income from foreign currency loans granted to residents, therefore, under the second paragraph of said section, to be subject to the 10% final tax, the income derived from dealings with residents must be the interest income from foreign currency loans granted by such depository bank.

Based on the facts presented, it is not disputed that the income reported by petitioner under its Income Tax Return as "foreign currency deposit unit (FCDU) transactions not subject to tax" pertain to commissions and gains realized from buying of foreign currency from individual and corporate clients, other than banks, and selling of foreign currency to individual and corporate clients, other than banks. In fact, respondent, in his Answer, emphasized that the subject income in the instant case, indeed pertained to the commissions and gains which petitioner realized from its transactions of buying and selling foreign currency from and to individuals and corporate clients, other than banks.

Respondent's reliance on Sections 2.27 and 2.28 of Revenue Regulations No. 10-98, or the rules implementing the provisions of Section 28(A)(7)(b), as his bases for the taxability of petitioner's commissions and gains derived from the buying and selling of foreign currency to and from individuals and corporate clients other than banks, is misplaced. Sections 2.27 and 2.28 of said revenue regulation are quoted below for easy reference:

> **Sections 2.27 and 2.28 – Corporate Income Tax on Interest Income from a Depository Bank under the Foreign Currency Deposit System.**

(A) x x x

(B) x x x

(C) Taxation 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 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 per cent (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.

x x x x x x x x x

Pursuant to the above regulations, the Bureau of Internal Revenue subjects to 10% final withholding tax all foreign currency transactions with residents of the Philippines, citing foreign exchange transactions with banks as included. Meaning, instead of limiting to the bank's foreign exchange transaction as subject to final withholding tax it expanded its coverage as to include all residents of the Philippines. Transactions with residents are subjected to both foreign exchange transactions and lending operations, when the law subjects it only to the latter.

It is not argued that constructions and interpretations given to a statute by agencies charged with the implementation of its rules and regulations are to be given great respect and should be accorded great weight by courts, however, this principle does not give way to such interpretations and constructions which tend to expand the law they seek to implement (*Conte vs. Commissioner on Audit, 264 SCRA 19*). In other words, if such interpretations and construction tend to go beyond the intention of the law, its allowance is then proscribed.

Nowhere in the said provision of law does it tax commissions and gains derived from the buying and selling of foreign currency to individuals and corporate clients, other than banks. When the law is very clear in its words and phrases, then there is no longer any room for further interpretation. Mere application of the law is required (*Paat vs. Court of Appeals, 266 SCRA 167*).

Furthermore, this Court agrees with petitioner that revenue regulations cannot be made to apply retroactively so as to cover transactions prior to its issuance. Section 246 of the 1997 NIRC provides for the non-retroactivity of rulings if any revocation, modifications or reversal of any of the rules and regulations promulgated are prejudicial to the taxpayer, save in the cases provided, which petitioner does not fall under any. However, in this case, both the Effectivity Clause and Transitory Provisions of Revenue Regulations No. 10-98 clearly were retroactive in nature and prejudicial to the taxpayer. For one, it taxes the petitioner on its supposed income received which when during the period they were earned were not yet subject to tax. Secondly, respondent is obviously misguided by his argument for it is evident from the transitory provision of the said revenue regulations that although the tax to be collected is not immediately due, still, petitioner is made liable.

Lastly, respondent contends that, on the assumption that petitioner is not liable to the 10% final tax under Section 28 (A)(7)(b) of the 1997 NIRC, it is still liable to the corporate income tax of 32% as said transactions are indeed taxable. Accordingly, there is no provision of law which exempts said transactions from tax.

This Court agrees. As exemptions are highly disfavored in law, he who claims exemptions must be able to justify his claim by the clearest grant of organic or statute law (*China Banking Corporation vs. Court of Appeals, G.R. No. 146749; Commissioner of Internal Revenue vs. China Banking Corporation G.R. No. 147938, June 10, 2003).* There is no provision of law which indeed exempts the incomes, more particularly, the commissions and gains derived from the buying and selling of foreign currency from and to individuals and corporate clients, other than banks. Thus, Section 28 (A)(1) of the 1997 Tax Code provides that resident foreign corporations shall be subject to an income tax equivalent to thirty two (32) percent of their taxable income derived from sources within the Philippines. As defined by Section 32 (A) of the 1997 Tax Code, gross income is "except when otherwise provided in this title, all income derived from whatever source, including (but not limited to) the following items: (1) compensation for services in whatever form paid, including, but not limited to, fees, salaries, wages, **commissions, and similar items**; (2) gross income derived from the conduct of trade or business or in the exercise of a profession x x x". By the very definition of the term "gross income" it is broad and comprehensive enough as to include commissions and gains derived from the buying and selling of foreign currency. The word "income from whatever source" discloses a legislative policy to include all income not expressly exempt within the class of taxable income under our laws. Income means "cash received or its equivalent"; it means something distinct from principal or capital. For, while capital is a fund, income is a flow.

Likewise, for a source of income to be considered as coming from the Philippines, it is sufficient that the income is derived from the activities within the Philippines. In the case of petitioner, it is not disputed that it is a resident foreign corporation, having a branch here in the Philippines. Therefore, pursuant to Section

28(A)(1), a corporation organized, authorized, or existing under the laws of any foreign country, engaged in trade or business within the Philippines like the petitioner, shall be subject to income tax with respect to other income not covered by Section 28 (A)(7)(b) equivalent to thirty two percent (32%) which respondent may perhaps look into. However, petitioner cannot be made liable to pay deficiency onshore tax on its onshore income pursuant to Section 28 (A)(7)(b) of the 1997 NIRC, considering that the commissions and gains which petitioner derived from its buying and selling of foreign currency from and to individuals and corporate clients other than banks, are not expressly included as subject to the ten per cent (10%) final tax. Section 28 (A)(7)(b) is a more specific provision of the 1997 NIRC as compared to the general provisions of Section 28 (A)(1) of the same Code.

IN VIEW OF THE FOREGOING, the subject Petition for Review is hereby **GRANTED.** Accordingly, respondent is **ORDERED TO CANCEL AND WITHDRAW** the deficiency onshore tax of petitioner for the taxable year ended December 31, 1998, including the compromise penalty and interest charges, in the amount of P6,147,662.50.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Justice

WE CONCUR:

LOVELL R. BAUTISTA
Associate Justice

CAESAR A. CASANOVA
Associate Justice

CERTIFICATION

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

ERNESTO D. ACOSTA
Chairman, First Division
Presiding Justice