REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

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PHILIPPINE VETERANS BANK,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 7095

Members:

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

Promulgated:

JUL 12 2007 - 10:00 AM

x - x

DECISION

BAUTISTA, *J.*:

This Petition for Review seeks the reversal of the Decision dated September 6, 2004 rendered by the Commissioner of Internal Revenue which denied petitioner's protest against deficiency Gross Receipts Tax (GRT) on Foreign Currency Deposit Unit (FCDU) assessment for the taxable year 2000 and ordered petitioner to pay the total amount of **NINE HUNDRED EIGHTY TWO THOUSAND SIXTY NINE AND 09/100 PESOS (P982,069.09)** plus interest after October 15, 2004.

The facts are not in dispute.

Petitioner Philippine Veterans Bank is a commercial banking institution organized and existing under and by virtue of the laws of the Republic of the Philippines, particularly

Republic Act No. 3518 (Philippine Veterans Bank's Charter) and Republic Act No. 7169 (An Act Rehabilitating Philippine Veterans Bank), with principal office address at PVB Building, 101 V.A. Rufino cor. Dela Rosa Sts., Legaspi Village, Makati City.

Respondent, on the other hand, is the duly appointed Commissioner of Internal Revenue with office address at the 4th Floor, BIR National Office Building, BIR Road, Diliman, Quezon City.

On May 7, 2004, petitioner received a Preliminary Assessment Notice (PAN) dated April 14, 2004[1] issued by the Officer-in-Charge of the Bureau of Internal Revenue (BIR) Large Taxpayers Service, Deputy Commissioner Estrelita C. Aguirre, assessing petitioner of deficiency Gross Receipts Tax in the total amount of P952,924.02, details of which are as follows:

Interest Income (FCDU)	
Loans	3,842,902.00
Deposit with other banks	2,188,618.00
Total Interest Income	6,031,520.00
Add: Miscellaneous Income	2,688,111.00
Gross Receipts Subject to GRT	8,719,631.00
GRT Rate	5%
Gross Receipts Tax Due	435,981.55
GRT Paid	-
Basic Tax Deficiency	435,981.55
Add: Surcharge	108,995.39
Interest up to 06.15.04	382,947.08
Compromise	25,000.00
TOTAL GRT DEFICIENCY	952,924.02

In reply to the foregoing PAN, petitioner, through its President and CEO, Ricardo A. Balbido, Jr., filed a protest-letter dated May 20, 2004 citing, among others, the following grounds:

1. that there is no clear basis of the assessment;
2. that the removal of the clause "exempt from all taxes" in the Tax Code of 1997 does not automatically subject interest income of FCDUs to Gross Receipts Tax;

[1] Exhibit "A"

3. in the absence of a provision imposing the tax, it is patently erroneous to impose Gross Receipts Tax to incomes from FCDUs;
4. the recent enactment of R.A. 9284 is a clear reaffirmation of the government's long standing policy to exempt FCDUs from all taxes; and
5. the matter subject of the assessment still remains an industry issue.

On July 6, 2004, petitioner received respondent's Formal Letter of Demand upholding the findings on the PAN of May 7, 2004 for petitioner's deficiency Gross Receipts Tax on FCDU for the taxable year 2000, with Details of Discrepancies as follows:

"Details of Discrepancies

Gross Receipts Tax – FCDU (Industry Issue): Assessment No. GRT-00-000036

As a brief background, pursuant to Section 24(e)(3) of the NIRC of 1977, the depository banks under the FCDU system shall be exempt from all taxes, except taxable income from such transactions. However, under the current NIRC of 1997 specifically Sec. 27(D)(3), that provision has been removed, hence this assessment."

This assessment notice was duly protested to by petitioner through a letter dated July 19, 2004.

On October 13, 2004, respondent issued his Final Decision on Disputed Assessment dated September 6, 2004, thereby affirming the assessment against petitioner for deficiency GRT on FCDU in the amount of P982,069.09 inclusive of interests up to October 15, 2004 and other penalties.

Consequently, pursuant to Section 228 of the National Internal Revenue Code of 1997 (NIRC), petitioner filed this instant Petition for Review on November 12, 2004.

On January 14, 2005, respondent filed his Answer, interposing the following as his Special and Affirmative Defenses, to wit:

"4. Onshore income is now subject not only to the 10% final tax under Section 27(D)(3) of the NIRC of 1997 but also to such other taxes in which said income may be classified as taxable in view of the deletion of the phrase "exempt from all taxes" from Section 27(D)(3) of the same Code (ING Bank [Manila Branch] vs. Commissioner of Internal Revenue, C.T.A. Case No. 6017, March 11, 2002).

5. In view of the deletion of the phrase "exempt from all taxes" from Section 27(D)(3) of the NIRC of 1997, petitioner's onshore income from foreign transactions is subject to gross receipts tax under Section 121 of the NIRC of 1997.

6. Under Section 121 of the Tax Code, gross receipts derived from sources within the Philippines by all banks and non-bank financial intermediaries shall be subject to a tax at the rate ranging from 0% to 5% depending on the remaining maturities of instruments from which such receipts were derived. A 5% rate shall be collected on gross receipts from royalties, rentals, property (real or personal), profits from exchange and all other items treated as gross income under Section 32 of the Tax Code. Thus, Section 121 of the NIRC of 1997 provides:

> Sec. 121. Tax on Banks and Non-bank Financial Intermediaries. - There shall be collected a tax on gross receipts derived from sources within the Philippines by all banks and non-banks 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:
>
> Short term maturity (not in excess of two (2) years.. 5%
> Med term maturity (over two (2) years but not exceeding four (4) years) 3%
> Long term maturity –
>
> (1) Over four (4) years but not exceeding seven (7) years 1%
> (2) Over seven (7) years 0%
>
> (b) On dividends 0%
> (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%
>
> xxx

7. All presumptions are in favor of the correctness of tax assessments. The good faith of tax assessors and the validity of their actions are presumed. They will be presumed to have taken into consideration all the facts to which their attention was called (*CIR vs. Construction Resources of Asia, Inc. 145 SCRA 671*). It is incumbent upon the taxpayer to prove the contrary (*Mindanao Bus Company vs. CIR, 1 SCRA 538; CIR vs. Tuazon, Inc., 173 SCRA 397*) and failure to do so shall vest legality to respondent's actions and assessments.

8. Taxes are the lifeblood of the nation, the Court has always applied the doctrine of strict interpretation in construing tax exemptions. Furthermore, a claim of statutory exemption from taxation should be manifest and unmistakable from the language of law on which it is based. Thus, the claimed exemption "must expressly be granted in a statute in a language too clear to be mistaken. (*Commissioner of Internal Revenue vs. Court of Appeals, 298 SCRA 83*)."

On February 26, 2007, this case was submitted for decision, after taking into consideration the Memorandum filed by petitioner without any being submitted by respondent.

As stipulated by the parties, the following are the issues for this Court's consideration:

"1. Whether or not petitioner's onshore income from foreign transactions is subject to gross receipts tax under Section 121 of the NIRC of 1997 in view of the deletion of the phrase 'exempt from all taxes' from Section 278(D)(3) *[should be 27(D)(3)]* for (sic) the same Code.

2. Whether or not the disappearance of the clause 'exempt from all taxes' in Section 27(D)(3) and Section 28(A)(7) in the 1997 Tax Code reflects the clear intent of the legislature to subject interest incomes from FCDUs to gross receipts tax.

3. Whether or not the Tax Code of 1997 specifically subject incomes from FCDUs to gross receipts tax.

4. Whether or not petitioner is liable to pay deficiency gross receipts tax on FCDU for taxable year 2000 in the aggregate amount of P982,069.09 plus 25% surcharge and 20% annual interest.

5. Assuming *arguendo* that petitioner is liable for the assessed tax, whether or not the computation of the tax liability is correct and accurate."

The issues being interrelated, this Court shall proceed to discuss them together.

Petitioner was assessed for its deficiency Gross Receipts Tax on its FCDU interest income for the taxable year 2000. It submits that it is not liable, for the following grounds, to quote:

1. There is no clear proof that when it enacted the Tax Code of 1997 the legislature intended to remove the exemption of FCDUs from non-income taxes. As a matter of fact, there is no record throughout the legislative deliberations of the 1997 Tax Code discussing the removal of this

exemption. In other words, the disappearance of the clause "exempt from all taxes" was simply an inadvertent clerical error.

2. There is no specific provision in the 1997 Tax Code imposing Gross Receipts Tax to FCDU interest incomes.

3. Assuming *arguendo* that petitioner is liable on assessed tax deficiency, the computation is erroneous and not accurate.

Petitioner, asserts that Congress did not intend to remove the exemption of FCDUs from non-income taxes. It argues that, "the old tax code exempts FCDU interest incomes (other than interest incomes from foreign currency loans granted to residents) from all taxes while the new tax code subjects FCDU incomes to final income tax. Since the intent to subject FCDU interest incomes to final tax would be inconsistent to the clause 'shall be exempt from all taxes' necessarily, this clause had to be removed from the provision. Otherwise, there would be an apparent inconsistency within the provision. Thus, Congress removed the clause 'shall be exempt from all taxes'. Unfortunately, when Congress removed the clause 'shall be exempt from all taxes' specifically to give way to the imposition of the final income tax, it failed to retain the exemption with respect to other taxes. Congress is supposed to retain the exemption with respect to the other taxes at least by way of proviso to reflect its true intent of imposing only the final income tax apparently through inadvertence, it failed to reinstate the clause, which thus caused respondent Commissioner to erroneously presume that FCDUs are now subject to other non-income taxes like the Gross Receipts Tax, as being done in the instant case." This allegedly finds support in the enactment of Republic Act No. 9294, or the "Act Restoring the Tax Exemption of Offshore Banking Units (OBUs) and Foreign Currency Deposit Units (FCDUs), amending for the purpose Section 27(D) and Section 28, Paragraphs (A)(4) and (A)(7)(b) of the National Internal Revenue Code as amended" on April 28, 2004. This being so, there is clearly an evident admission on the part of the Government that there was a drafting mistake in the 1997 Tax Code.

The Court is not swayed by petitioner's ratiocinations. Prior to the amendment introduced by the National Internal Revenue Code (NIRC) of 1997, Section 25(a)(6)(B) of the 1977 Tax Code provides that:

> "**(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 non-residents, offshore banking units in the Philippines, local commercial banks including branches of foreign banks that may be authorized by the Central Bank of the Philippines 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 Secretary 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.
>
> Any income of non-residents from transaction with depositary banks under the expanded system shall be exempt from income tax. (*Emphasis supplied*)

With the amendments made to the said provision under the NIRC 1997, the phrase "exempt from taxes" has been deleted in Section 27(D)(3)[2], to wit:

> "**(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.
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> Any income of nonresidents, whether individuals or corporations, from transactions with depository banks under the expanded system shall be exempt from income tax."

[2] And Section 28 (A)(7)(b) of the same Code

By the clear import of the present law, income derived by a depository bank under the foreign currency deposit system units from foreign currency transactions with local commercial banks shall be subject to a final tax of ten percent (10%). The phrase **"exempt from all taxes"** has definitely been deleted by Congress. The amendment by deletion of certain words or phrases in a statute indicates that the Legislature intended to change the meaning of the statute[3]. It is a basic rule in statutory construction that there is no safer nor better canon of interpretation than that when the language of the law is clear and unambiguous, it should be applied as written.

Petitioner cannot argue that there was no intent on the part of Congress to delete the phrase "exempt from all taxes". In the August 11, 1997 deliberations of the Senate, in connection with Section 28(A)(7)(b) of the NIRC of 1997, of which Senator Enrile was the author, this intent was clearly present, to quote[4]:

> "Senator Angara: Yes, Mr. President. Let me move to my next point, and that is the lifting of the preferential tax treatment of FCDUs as well as OBUs.
>
> Mr. President, would this not cause some drastic consequences on offshore as well as foreign currency deposits which I understand today are the prime sources of our current account spending? Many of our exporters depend on this FCDUs and OBUs for their foreign exchange needs, and if we remove the preferential tax treatment that we (sic) have been enjoying all these years, are we not going to drive away the foreign currency deposits and OBUs from our shore?
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> Senator Enrile: Mr. President, money goes to a place where it can make money. Whether we have the tax on FCDUs or OBUs, if depositors can make a margin that is favorable to them, they will be here. Business makes profit because it assumes risk.
>
> I do not subscribe to the theory that these people will run away. In fact, they are saying that because of the announcement we made, on this FCDUs, deposits are flying away from the country. But if we look at the figures, Mr. President, out of a total of P17 billion or so, only a little over P200 million left the country. But, I think, this P200 million left the country to pay for obligations in order to stave off a potential increase in the peso equivalent of the foreign currency obligation, and not because of the effort to tax FCDUs. That is one.

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[3] Gloria vs. Court of Appeals, 306 SCRA 287
[4] Transcript of the Senate Session on the Tax Reform Act on August 11, 1997

Two, we are not discussing here a problem of competition between pesos and dollars or deutschmark or francs. We are talking here of equity in taxation, Mr. President. These are the more affluent members of the taxable community and yet, they get away with their tax burden. Another thing that I cannot take is, as a member of this Senate and as a member of the community, that we should tax depositors of our own currency in banks and exclude from taxation depositors of foreign currencies. We are insulting our own currency.

Senator Angara: Mr. President, I can accept all the reasons given by the sponsor. But this repeal of the exemption to me is a very strong signal that we are changing policies in the middle of the stream. We attracted these FCDUs as well as OBUs on the premise that their income will be subject to special tax or in some cases, the offshore income of FCDUs will be exempt from any taxation. Now we are saying, "No, we do not need you anymore."

Unfortunately, Mr. President, based on our representation in the past, they come here and they have transacted business, they have helped exporters and other Filipinos needing foreign exchanges, and now we are saying "No more".

Is it not a very drastic message we send to the financial market of the world?

Senator Enrile: Mr. President, it is good that this point was raised by the distinguished gentleman from Aurora.

I would like to put into the *Record* that the exemption of FCDUs from paying income tax in the Philippines as well as the secrecy of their bank deposits was introduced in 1977, on November 21, 1977, under Presidential Decree No. 1246 by the then President Ferdinand E. Marcos. I would like to remind the nation and this Chamber that they have been enjoying this tax concession since then.

But what have they done at a time when we were in crisis? In 1983, 1984, 1985, 1986 all the way to 1990, they all flew away. They left the country. So it is not really a question of taxation that is involved here. It is a question of whether the economy is stable enough, strong enough to lessen the risk. They will withdraw from this country even if we give them all these tax concessions and the secrecy for as long as they feel that they are going to risk their capital because of the economic weakness of the country—not because we are taxing them. They will remain here as other foreign businessmen and Filipino businessmen will remain in business even if we tax them if they can make money."

The fact remains that Congress passed Senator Enrile's amendment removing the tax exemption of Offshore Banking Units (OBUs) and FCDUs on their foreign currency transactions. The intention of Congress to subject OBUs and FCDUs to tax is thus clearly manifested. Effectively, there being no effective exemption to speak of in this case, then all applicable taxes became due. A subsequent enactment of a law restoring the tax exemption is of no moment. It does not likewise necessarily follow that when Republic Act No. 9294[5] was enacted restoring the tax exemption of FCDUs and OBUs, the same showed the true intent of the Legislature during the time when the amendment deleting the phrase "shall be exempt from all taxes" was in effect. Nor does it mean that the restoration moved to apply retroactively the tax exemption of FCDUs and OBUs. In other words, prior to the effectivity of the subsequent law restoring the subject tax exemption, there was no longer a tax exemption to speak of in view of the amendment made on the subject provision of law.

It must be noted that the ten percent (10%) final tax levied on onshore income under Section 27(D)(3) of the 1997 NIRC pertains to income derived by a depository bank under the expanded foreign currency deposit system. It does not include the Gross Receipts Tax which is a form of excise tax. Just as a documentary stamp tax is imposed upon the exercise of a privilege, in like manner, the GRT is imposable when the bank exercises the privilege of engaging in foreign currency transactions or business.

In fact, the issue of taxability or removal of exemption of FCDU from taxes had been long settled by this Court in the case of **ING Bank (Manila Branch) vs. Commissioner of Internal Revenue.**[6] The pertinent portion of the Decision is quoted hereunder, to wit:

> "The phrase "exempt from all taxes" has been definitely deleted by the legislators. **The amendment by deletion of certain words or phrases in a statute indicates that the legislature intended to change the meaning of the statute** (Gloria vs. Court of Appeals, 306 SCRA 287). By virtue of such deletion, Revenue Regulations No. 10-76, which implemented the old law, is no longer applicable. In other words, the payment of the 10% final tax on FCDU income does not exempt Petitioner from the payment of branch profit remittance tax or other taxes for that matter". (*Emphasis supplied*)

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[5] An Act Restoring the Tax Exemption of Offshore Banking Units (OBUs) and Foreign Currency Deposit Units (FCDUs), amending for the purpose Section 27(D) and Section 28, paragraph (A)(4) and (A)(7)(b) of the National Internal Revenue Code as amended

[6] CTA Case No. 6017, March 11, 2002.

In the absence of any justification for this Court to make a different finding or interpretation regarding the taxability of FCDU income and transactions, then the above opinion remains.

Since taxes are the lifeblood of the nation, this Court has always applied the doctrine of strict interpretation in construing tax exemptions. Furthermore, a claim of statutory exemption from taxation should be manifest and unmistakable from the language of the law on which it is based. Hence, the claimed exemption "must expressly be granted in a statute stated in a language too clear to be mistaken"[7]

To reiterate, under the NIRC of 1997, the phrase "shall be tax exempt from all taxes" relative to FCDUs can no longer be found. Petitioner's insistence that it is still covered by the tax-exempt provision of the old law is quite absurd and contrary to sound reasoning. As this Court had already discussed, the NIRC of 1997 mandates payment of GRT, thus, petitioner must prove that it is exempt from the payment thereof and not the other way around.

Finally, as regards the issue on the correct amount of interest imposed by respondent, this Court partially finds for petitioner.

A thorough examination of the records of the case reveals that indeed respondent made a mistake in his computation of the interest imposable against petitioner for its deficiency Gross Receipts Tax on FCDUs. However, this Court does not subscribe to petitioner's submission that the interest to be charged must start from January 25, 2003. Although respondent's Formal Letter of Demand, from which his Final Decision on Disputed Assessment was based, shows that the interest due is computed starting January 25, 2003, this unmistakably is a result of a typographical error. It cannot be overemphasized that the taxable year covered is for 2000. Gross Receipts Tax (GRT) returns are filed on a quarterly basis and the tax due thereon is to be paid within twenty five (25) days after the end of

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[7] Commissioner of Internal Revenue vs. Court of Appeals, 298 SCRA 83

each taxable quarter[8].

In this instant case, for the taxable year ending in December 31, 2000, the last day of payment for the GRT on FCDU would then be on January 25, 2001. Consequently, for petitioner's deficiency GRT on FCDU, the interest due should be computed from January 25, 2001, and not on January 23, 2003 as erroneously stated on the notices and Final Decision. Counting from January 25, 2001 up to October 15, 2004, the correct amount of interest due would only have a factor of .745 (i.e., 1360 days x 20% /365 days per year). In this regard, petitioner's interest for deficiency GRT on FCDU should only be in the amount of P324,806.26.

Petitioner, likewise, cannot be made to pay the compromise penalty of P25,000.00. The imposition of a compromise penalty presupposes an arrangement or agreement between the parties as to the payment of the amount due. As the same is not present in this case, no compromise penalty may be imposed.

IN VIEW OF THE FOREGOING, the subject Petition for Review is hereby **PARTIALLY GRANTED**. Accordingly, petitioner is hereby **ORDERED TO PAY** respondent the modified amount of **EIGHT HUNDRED SIXTY NINE THOUSAND SEVEN HUNDRED EIGHTY THREE AND 20/100 PESOS (P869,783.20)** representing deficiency Gross Receipts tax on FCDU for taxable year 2000, computed as follows:

Interest Income (FCDU)	
Loans	3,842,902.00
Deposit with other banks	2,188,618.00
Total Interest Income	6,031,520.00
Add: Miscellaneous Income	2,688,111.00
Gross Receipts Subject to GRT	8,719,631.00
GRT Rate	5%
Gross Receipts Tax Due	**435,981.55**
GRT Paid	-
Basic Tax Deficiency	435,981.55
Add: Surcharge	108,995.39
Interest 1.25.01 to 10.15.04	324,806.26
TOTAL GRT DEFICIENCY	**869,783.20**

[8] Section 128(A)(1), NIRC of 1997 in relation to Section 121 of the same Code

In addition, a twenty (20%) percent delinquency interest per annum from October 16, 2004 until such amount is fully paid is hereby imposed, pursuant to Section 249 of the NIRC of 1997, as amended.

SO ORDERED.

LOVELL R. BAUTISTA
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

CAESAR A. CASANOVA
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, 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's Division.

ERNESTO D. ACOSTA
Presiding Justice
Chairperson, First Division