REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PACIFIC BANKING CORPORATION,
Petitioner,

-versus -

C.T.A. CASE NO. 3520

COMMISSIONER OF INTERNAL REVENUE,
Respondent.
x - - - - - - - - - - - - - - x

5/20/91

D E C I S I O N

This is an appeal by petitioner, a duly registered domestic corporation engaged in the business of banking from a decision of respondent Commissioner of Internal Revenue disallowing deductions of certain items representing creditable taxes, miscellaneous expenses, donations, correction of prior year's bonuses and interest expense on indebtedness incurred to purchase tax-exempt obligations.

In two letters both dated November 16, 1981, (CTA rec. pp. 8-11), respondent assessed and demanded from petitioner the aggregate amount of P11,729,839.44 as deficiency income taxes for the years 1976, 1977, 1978 and for withholding tax on dividends for the year 1976, the computation of which is broken down as follows:

1976 Income Tax

Net Income per return		P23,077,028.75
Add: Unallowable deduction:		
Interest Expense	P5,522,886.77	
Taxes (surcharges)	5,810.04	
Miscellaneous Expense	9,740.00	
T O T A L	P5,538,436.81	
Less: 1976 bonus disallowed in 1977	3,661,951.98	1,876,484.83
Net income per investigation		P24,953,513.58
Tax due thereon		P 8,723,729.75
Less: Income tax already assessed		8,066,960.00
Balance		P 656,769.75
Add: Maximum interest at 42%		275,843.30
TOTAL AMOUNT DUE AND COLLECTIBLE		P 932,613.05

1977 Income Tax

Net Income per return		P 8,920,267.19
Add: Unallowable deduction:		
Interest Expense	P9,745,474.91	
Correction of prior years bonus	3,661,951.98	
Donation (Excessive)	6,167.72	13,413,594.61
Net income per investigation		P22,333,861.80
Tax due thereon		P 8,455,452.00
Less: Income tax already assessed		3,371,148.00
Balance		P 5,084,304.00
Add: 14% int. fr. 4-16-78 to 7-31-80		1,631,214.00
20% int. fr. 8-1-80 to 4-16-81		720,276.00
TOTAL AMOUNT DUE AND COLLECTIBLE		P 7,435,794.00

1976 Withholding Tax on Dividends

1st Quarter

Amount subject to tax	P 38,496.00	
Tax due thereon	P 3,849.60	
Add: surcharge	962.40	
maximum interest at 42%	1,616.83	6,428.83

2nd Quarter

Amount subject to tax	P 38,496.00	
Tax due thereon	P 3,849.60	
Add: surcharge	962.40	
maximum interest at 42%	1,616.83	6,428.83

3rd Quarter

Amount subject to tax	P	38,496.00	
Tax due thereon	P	3,849.60	
Add: surcharge		962.40	
maximum interest at 42%		1,616.83	6,428.83
Add: Compromise penalty			100.00
TOTAL AMOUNT DUE AND COLLECTIBLE			P 19,386.49

1978 Income Tax

Net Income per return		(P 7,121,770.29)
Add: Unallowable deduction:		
Interest Expense	P12,945,847.34	
Miscellaneous Expense	5,887.99	
Charitable contribution	3,553.00	12,955,288.33
Net income per investigation		P 5,833,518.04
Tax due thereon		P 2,323,407.00
Add: 14% int. fr. 4-16-79 to 7-31-80		419,963.75
20% int. fr. 8-1-80 to 11-16-81		598,675.15
TOTAL AMOUNT DUE AND COLLECTIBLE		P 3,342,045.90

In other words, the total deficiency income tax due and collectible from petitioner for the year 1976 is P932,613.05, P7,435,794.00 for 1977 and P3,342,045.90 for 1978; and the total amount due and collectible from petitioner representing the 1976 withholding tax on dividends is P19,386.49 These amounts total to P11,729,839.44.

In another letter dated May 24, 1982, (CTA rec. p. 21), respondent further assessed and demanded from petitioner an additional deficiency income tax of P1,171,510.32 for the year 1977 as computed below:

Compensation/fringe benefits per 1977 income tax return	P27,923,571.46
Less: Compensation/fringe benefits per 1977-1976 consolidated statement of earnings and expenses	24,259,774.79
Discrepancy	P 3,663,796.67
Income tax due thereon	P 1,282,329.00
Add: Corporate dev. tax	106,401.00
Total tax due	P 1,388,730.00
Less: Over-payment per 1977 income tax return	638,781.00
Deficiency Income Tax due	P 749,949.00
Add: 10 sur. for late payment	74,994.90
14% int. fr. 4-15-78 to 7-31-80	240,823.62
20% int. fr. 8-1-80 to 4-15-81	105,742.80
Total amount due and collectible	P 1,171,510.32

Through a letter dated December 24, 1981, (CTA rec., p. 14), petitioner protested the first assessment dated November 16, 1981. Two days later, (December 18, 1981), petitioner remitted the withholding taxes on dividends in the total amount of P32,344.15 (Exh. A-1 and B-1, pp. 77-78, CTA rec.). Then on March 22, 1982, petitioner likewise paid the sum of P16,865.46 (p. 81, CTA rec.) representing the applicable income taxes on all donations, taxes and miscellaneous expenses which were disallowed in the above assessments. (CTA rec., pp. 18, 19, 20.)

Subsequently, in a letter dated August 19, 1982 (CTA rec., p.22), petitioner protested the second assessment for 1977. Respondent, in its letter dated August 31, 1982, (CTA rec., p.25) issued a final decision by demanding from petitioner payment of the total sum of P11,710,452.95 as deficiency income tax for the years 1976, 1977 and 1978. Reproduced below is the letter of respondent:

> Re: PACIFIC BANKING CORPORATION
> 1976, 1977 and 1978 Deficiency Income Tax
>
> "This has reference to your letter of protest dated December 24, 1981 filed on behalf of your client, PACIFIC BANKING CORPORATION, against our 1976,1977 and 1978 deficiency income tax assessments in the aggregate income tax of P11,710,452.95, subject of two letters of demand both dated November 16, 1981."
>
> "Records show that the deficiency income tax was brought about by the disallowances of taxes, miscellaneous expenses, donations, correction of prior year's bonus in the amount of P3,661,951.98 for the year 1977 and disallowance of interest expenses on indebtedness incurred or continued to purchase or carry obligations the interest of which is tax-exempt pursuant to Section 30(b)(i) of the Tax Code as amended. It appears that your client was aggreable to the disallowance only of donations, taxes and miscellaneous expenses."
>
> "The question raised in your protest with regards to the disallowance of interest expense is also the same issue on other tax cases awaiting the final decision of the court."
>
> "In view thereof, and since no final adverse decision has yet been issued

thereon, it is hereby requested that your client be advised to settle fully the aforesaid assessment without further delay."

"This is our final decision on the matter xxx."

Very truly yours,

(SGD.) RUBEN B. ANCHETA
Acting Commissioner"

Hence, this appeal by the petitioner.

Petitioner paid the withholding tax on dividends declared in 1976 (P19,386.49, Exh. A-1) and 1977 (P12,957.66, Exh. B-1), the taxes corresponding to miscellaneous expenses and taxes disallowed in 1976 (P7,728.36, Exh. C-1) the tax corresponding to donation disallowed in 1977 (P3,419.03, Exh. D-1) and to miscellaneous expenses and charitable contributions disallowed in 1978 (P5,718.07, Exh. E-1). In one of the hearings on February 19, 1986, petitioner manifested that the main portion of the assessment involved herein, that is, interest expense has already been submitted to a compromise. Petitioner further alleged that it has already paid the tax thereof and what remained were other items involving questions of law. (CTA rec., p. 64.)

Apparently, the issue is now limited to whether the interest expense should be disallowed.

The evidence submitted by respondent consisted of Exhibits 2, 3, and 4 which show the recomputation of the income tax liability on the disallowed interest expense based on the Bureau of Internal Revenue-Bankers Association of the Philipppines Compromise Agreement.

By virtue of the Bureau of Internal Revenue - Bankers Association of the Philippines Compromise Agreement, the petitioner is liable to pay the deficiency income tax of P87,908.63, P235,867.00, and P259.00 for the years 1976, 1977, and 1978, respectively, which totals P324,034.63 (Exh. 2, 3 and 4).

Petitioner does not contest the correctness of respondent's recomputation based on the said compromise agreement.

Due to this recent turn of events, the question with which this Court is now faced is whether or not to consider and respect the BIR-BAP compromise agreement entered by the parties.

In general, compromises are allowed and enforceable provided these two requisites are present: first, that the subject matter is not prohibited; and second, that the person entering into it is duly authorized.

Under Articles 2034 and 2035 of the New Civil Code, tax liability is among the items that can be compromised.

Moreover, in the National Internal Revenue Code, the Commissioner of Internal Revenue is expressly authorized to enter, under certain conditions, into a compromise of both the civil and criminal liabilities of the taxpayer (Sec. 295, 1977 NIRC, now Sec. 204, NIRC). Hence, the contracts to which he enters into are enforceable as against the government.

The BIR-BAP compromise agreement entered by the petitioner, Pacific Banking Corporation and respondent Commissioner of Internal Revenue possesses the two above-mentioned requisites to make it enforceable.

WHEREFORE, petitioner Pacific Banking Corporation is hereby liable for the sum of **P342,034.63 on disallowed interest expense based on the BIR-BAP compromise agreement.**

With costs against petitioner.

SO ORDERED.

Quezon City, Metro Manila, May 20, 1991.

CONSTANTE C. ROAQUIN
Associate Judge

WE CONCUR:

ALEX Z. REYES
Presiding Judge

ERNESTO D. ACOSTA
Associate Judge

C E R T I F I C A T I O N

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

ALEX Z. REYES
Presiding Judge
Court of Tax Appeals