REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE
Petitioner,

-versus-

DEUTSCHE BANK AG MANILA BRANCH,
Respondent.

C.T.A. EB No. 113
(C.T.A. Case No. 6566)

Members:
Acosta, *P.J.*,
Castañeda, Jr.,
Bautista,
Uy,
Casanova,
Palanca-Enriquez, *JJ.*

Promulgated:

SEP 19 2006

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DECISION

CASTAÑEDA, JR., *J.*:

This is a Petition for Review filed by the Commissioner of Internal Revenue with the Court of Tax Appeals *en banc* (the Court *en banc*) pursuant to Section 18 of Republic Act No. 9282. The petition seeks to reverse and set aside (1) the May 17, 2005 Decision rendered by the First Division of this Court (the Court in Division) in C.T.A. CASE No. 6566 captioned *Deutsche Bank AG Manila Branch vs. Commissioner of Internal Revenue* wherein the Court in Division ordered the respondent therein 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 and (2) the Resolution of the Court in Division dated August 16, 2005 denying the Motion for Reconsideration of the Commissioner of Internal Revenue.

The facts that are relevant to this appeal as culled from the Decision of the Court in Division are as follows:

> Respondent, 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.
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> On December 21, 2001, respondent received a Preliminary Assessment Notice dated November 12, 2001 for deficiency withholding taxes on compensation, expanded withholding, fringe benefits tax, income tax on onshore income, gross receipts tax and documentary stamps tax for the year ended December 31, 1998 in the total amount of P39,101,977.49 inclusive of interest.
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> On January 22, 2002, respondent received a Formal Letter of Demand dated January 18, 2002 with the corresponding Assessment Notice No. 98-000031 dated January 8, 2002 demanding payment of deficiency taxes in the total amount of P39,650,263.65 inclusive of interest and compromise penalties.
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> On January 31, 2002, respondent, after evaluating the different tax issues, paid the amounts of P275,788.94 as deficiency Expanded Withholding Tax and P330,292.30 as deficiency Fringe Benefits Tax for the taxable year ended December 31, 1998. Respondent disputed the rest of the deficiency assessments in a protest letter filed with the Bureau of Internal Revenue (BIR) on

February 21, 2002 stating therein its arguments for the cancellation and or reconsideration of the formal letter of demand. Respondent likewise submitted on April 18, 2002 all the supporting documents in compliance with the provisions of law.

On October 18, 2002, respondent received a letter from the then Assistant Commissioner of the Bureau of Internal Revenue's Large Taxpayers Service, Atty. Edwin R. Abella, informing respondent of the results of the BIR's reinvestigation on the 1998 deficiency tax assessments against the respondent as conducted by the petitioner'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), broken down as follows:

Income tax on onshore income	P6,149,662.50
Withholding Tax – Expanded	273,788.74
Fringe Benefits Tax	330,292.50
Total Deficiency Taxes	P6,753,743.74
Less: Payments	606,081.24
Balance	P6,147,662.50

In effect, the original assessments made against the respondent for deficiency withholding taxes on compensation, gross receipts tax, and documentary stamp taxes were all cancelled.

Construing the above response as the Commissioner's partial denial of its protest letter, respondent filed a Petition for Review with the Court of Tax Appeals docketed as C.T.A. CASE No. 6566 on November 14, 2002.

The issues stipulated by the parties and presented before the Court in Division for resolution were the following:

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 Deutche Bank is liable to pay the aggregate amount of P6,147,662.50 as deficiency onshore income tax for taxable year 1998.

As stated at the outset, the Court in Division granted the Petition for Review in C.T.A. CASE No. 6566 and ordered the respondent therein (the Commissioner of Internal Revenue) to cancel and withdraw the deficiency onshore tax of petitioner for the taxable year ended December 31, 1998 in the total amount of P6,147,662.50 including the interest and compromise penalty. The dispositive portion of the Court in Division's Decision dated May 17, 2005 reads as follows:

> "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.
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> SO ORDERED."

On June 9, 2005 the Commissioner of Internal Revenue filed a Motion for Reconsideration of the aforementioned Decision. The Commissioner's Motion for Reconsideration was subsequently denied by the Court in Division in a Resolution dated August 16, 2005, the dispositive portion thereof reads as follows:

> "WHEREFORE, in view of the foregoing, respondent's Motion for Reconsideration is hereby DENIED for lack of merit. This Court's Decision of May 17, 2005 is hereby AFFIRMED in all respects.
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> SO ORDERED."

Hence, this appeal by the Commissioner of Internal Revenue by way of a Petition for Review. In his Petition for Review, the petitioner raised only one issue:

> **WHETHER OR NOT THE COMMISSIONS AND GAINS REALIZED BY THE PETITIONER FROM FOREIGN CURRENCY TRANSACTIONS ARE TAXABLE.**

PETITIONER'S ARGUMENTS

According to the petitioner, the commissions and gains realized from buying and selling foreign currency from and to individual and corporate clients other than banks are taxable at 10% because the enumeration of the income found in Section 28 (A) (7) of the 1997 NIRC suggests that dealings by an FCDU involving foreign currency transactions are limited only to those conducted with local commercial banks and branches of authorized branches of foreign banks. With this premise, petitioner concludes that FCDUs and OBUs "are also only authorized as intended by the laws that mandated them, more particularly Republic Act Nos. 6426, 1034, 1035 and Presidential Decree No. 1773, to conduct foreign currency transactions with local commercial banks and authorized branches of foreign banks. However, our internal revenue laws are not bound to subject to tax only authorized transactions. If a taxpayer conducts a business beyond what is authorized of him, other income derived therefrom is similarly taxable. Should these transactions become authorized, they remain taxable unless exempted by statute. Such is the situation of the herein respondent."

Petitioner avers that Revenue Regulations No. 10-98 implements the Tax Code provision on the imposition of income taxes on income derived under the foreign currency deposit and offshore banking systems. According to the petitioner, said revenue regulations did not alter, modify or amend the intent of the law. The intention of said revenue regulations, as clearly suggested by its title, is to cover the imposition of income taxes on income derived under the Foreign Currency Deposit and Offshore Banking System. Thus, the commissions and gains realized from buying and selling foreign currency from and to individual and corporate clients other than banks are taxable at 10% pursuant to Section 28 (A) (7) (b) of the Tax Code, as amended and the related section of Revenue Regulations No. 10-98.

Petitioner posits that assuming but without admitting that said transaction is not covered by Revenue Regulations No. 10-98 which provides for a preferential 10% final tax rate applicable to banking industries engaged in foreign currency deposit and offshore banking system, still the respondent may be liable for the regular corporate income tax of 34% (year 1998) because said transactions are indeed taxable. There is no particular provision of the law which categorically exempts said transactions from tax.

RESPONDENT'S ARGUMENTS

Respondent argues that petitioner introduced a new argument that was not raised during the trial of the case. According to the respondent, petitioner claims that the enumeration of the incomes subject to tax under Section 28 (A) (7) (b) of the Tax Code suggests that dealings with an FCDU involving foreign currency transactions are limited only to those conducted with local commercial banks and branches of authorized branches of foreign banks. He then proceeds to conclude that FCDU and OBU are only authorized to conduct foreign exchange transactions with local commercial banks and authorized branches of foreign banks. Respondent raises its objection to the belated introduction thereof in the Motion for Reconsideration and in this Petition for Review. The argument was not part of the issues presented before the First Division. It cannot be used now in this petition for review, since petitioner and respondent are limited to the issues raised at the trial. In other words, the petitioner should not be allowed to raise or cite this argument in support of this petition.

Respondent asserts that "if Section 28 (A) (7) (b) of the Tax Code clearly enumerates, to use the words of the petitioner, the incomes stated therein to be subjected to 10%, how can Revenue Regulations 10-98 include other incomes derived from the FCDU and Offshore Banking System and subject it to 10%? Clearly, Revenue Regulations 10-98 went beyond what the law provides and this must be corrected." Moreover, respondent reiterates its argument that the retroactive effect of Revenue Regulations 10-98 is invalid. It cannot be made to apply retroactively to cover transactions prior to its issuance.

According to the respondent, petitioner in this appeal seeks an alternative relief for the first time, that is, that this Honorable Court issue an order declaring the Respondent liable to the regular corporate income tax at 34% (year 1998) or P11,992,771.00, based on the total gains realized covering the same transactions and taxable year subject to adjustment of increments provided for in the Tax Code [Section 28 (A) (7) (b)]. Respondent argues that petitioner has absolutely no right to seek this alternative prayer because not only did he fail to raise it during trial, he is prohibited from doing so because it would violate the right of the respondent to due process of law.

Lastly, respondent submits "that not only is the petitioner prohibited from using these proceeding to make a new assessment against respondent, he is likewise barred from issuing an assessment against the respondent because his right to do so has prescribed. The income subject of this case has been reported in respondent's income tax return for 1998. Petitioner insisted on imposing upon respondent the 10% final tax instead of the 34%. Petitioner cannot do so now as it has been more than six (6) years since the return has been filed."

THIS COURT'S RULING

The petition for review is bereft of merit.

COMMISSIONS AND GAINS REALIZED FROM BUYING AND SELLING OF FOREIGN CURRENCY FROM INDIVIDUAL AND CORPORATE CLIENTS, OTHER THAN LOCAL/FOREIGN BANKS, ARE NOT SUBJECT TO THE 10% FINAL TAX IMPOSED UNDER SEC. 28 (A)(7)(B)

Section 28 (A) (7) (b) of the 1997 NIRC provides:

Section 28. Rates of income tax on foreign corporations. –

(A) *Tax on Resident foreign corporations . –*

(7) Tax on certain incomes received by a resident foreign corporation. —

(a) xxx xxx xxx

(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 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 individuals or corporations, from transactions with depository banks under the expanded system shall be exempt from income tax. *(Emphasis supplied)*

On the other hand, Sections 2.27 and 2.28 of Revenue Regulations No. 10-98[1] dated August 25, 1998, in part provides:

(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

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[1] 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

> 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. *(Emphasis supplied)*

A reading of the foregoing provisions reveals that Revenue Regulations No. 10-98 **expanded the coverage of Sec. 28 (A) (7) (b)** by imposing the 10% final tax also on income of FCDU's and OBU's derived from foreign currency transactions with all residents of the Philippines, individual and corporate, contrary to the express language of Section 28 (A) (7) (b) of the 1997 NIRC which imposes the 10% final tax only on income of FCDU's and OBU's derived from foreign currency transactions with local commercial banks, branches of foreign banks and other depository banks. In this regard, the Revenue Regulation did not only implement Section 28 (A)(7)(b) of the 1997 NIRC but also modified the said law. Consequently, that portion of Revenue Regulations No. 10-98 which imposes the 10% final tax on the income derived by the FCDUs and OBUs from foreign currency transactions ***with all residents*** of the Philippines is void and of no binding effect. It is well-settled that all administrative "issuances must not override, but must remain consistent and in harmony with the law they seek to apply and implement. Administrative rules and regulations are intended to carry out, neither to supplant nor modify, the law." [2] We quote with approval the ratiocination of the Court in Division, thus:

> "From the above provision of law, the income subject to ten per cent (10%) final tax are the following:
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> 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
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> 2. **Interest income** of such depository banks **from foreign currency loans granted** under the expanded foreign currency deposit system **to residents**.
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> Since the income 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 [commercial banks including] 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**.
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> 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.**
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> 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

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[2] *Commissioner of Internal Revenue vs. The Hon. Court of Appeals, R.O.H. Auto Products Philippines, Inc. and The Hon. Court of Tax Appeals,* G.R. No. 108358, January 20, 1995 (240 SCRA 368).

> currency to and from individuals and corporate clients other than banks, is misplaced. 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.
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> xxx xxx xxx
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> 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)*." [3] *(Emphasis supplied)*

It is also a well-settled rule in taxation that a statute will not be construed as imposing a tax unless it does so clearly, expressly and unambiguously. A tax cannot be imposed without clear and express words for that purpose. Accordingly, the provisions of a taxing act are not to be extended by implication.[4]

PETITIONER CANNOT CHANGE THE BASIS OF THE ASSESSMENT WITHOUT COMPLYING WITH THE PROVISIONS OF SEC. 228 AND SEC. 203 OF THE 1997 NIRC

In defending the validity of the formal assessment notices, the petitioner thru Assistant Commissioner Edwin R. Abella of the Large Taxpayers Service wrote a letter dated October 17, 2002 (*Exhibit "I"*,

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3 Assailed Decision, pp. 10-13.

4 *Marinduque Iron Mines Agents, Inc. vs. The Municipality of Hinabangan, Province of Samar,* No. L-18924, June 30, 1964 (11 SCRA 416).

page 399, CTA Records) to respondent stating that the basis of the assessment was Sec. 28 (A)(7)(b) as implemented by Revenue Regulations No. 10-98, thus:

> "The legal basis by our Audit & Investigation Division in pursuing the collection of the said tax on onshore income with due recognition of your arguments and facts presented during re-investigation are as follows:
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> a. Your view that the Formal Assessment Notices were void since these notices did not state the law, rules and regulations on which the assessment was based, are herein considered without basis due to the following: Firstly, the principal issue here is the claim of exemption by not subjecting to tax the said amount of income when the income tax return on FCDU operations was filed. Secondly, the legal basis of disallowing such claim of exemption was clearly stated by citing previous court decisions and jurisprudence in the Demand Letter. Thirdly, after having considered such income as duly taxable, **the tax applied in the assessment was the same tax it claimed to be exempted from, which were the provisions of Sec. 28 (A)(7)(b) or the 10% onshore tax.** Citing said provision of law was no longer necessary in the circumstance since doing so would merely be a reiteration of what taxpayer used as its legal basis as appearing in the return filed. xxx"
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> b. During reinvestigation, it was established that subject income were commissions and gains realized from buying and selling foreign currency from and to individual and corporate clients other than banks. However, these types of income **are still considered taxable under Section 28 (A)(7)(b) and Revenue Regulation 10-98 or subject to the 10% onshore tax**.
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> c. We submit that Sec. 28(A)(7)(b) only clearly enumerated the following income to be subject to the 10% tax: (1) Income derived by an FCDU from foreign currency transactions with local commercial banks and branches of foreign currency loans granted by FCDU and (2) interest income from foreign currency loans granted by FCDU to residents. **However, by provisions of Revenue Regulations 10-98,** known as the "Implementing Regulations of the Provisions of the National Internal Revenue Code, as amended by R.A. 8424, relative to the Imposition of Income Taxes on Income Derived under the Foreign Currency Deposit and Offshore Banking Systems", **said income is made also taxable at 10%**. xxx" *(Exhibit I-1, CTA Records, p. 400). (Emphasis supplied)*

The foregoing excerpts from *Exhibit "I"* clearly state that the assessment for deficiency tax on respondent's onshore income was based on Sec. 28 (A)(7)(b) of the 1977 NIRC and paragraph (C) of Sections 2.27 and 2.28 of Revenue Regulations No. 10-98. Considering that the assessment for deficiency income tax was based on respondent's alleged liability to the 10% final tax imposed by Sec. 28 (A)(7)(b), the respondent, therefore, cannot be held liable for the regular corporate income tax of 34% of the net taxable income precisely because the assessment notice was not based on Sec. 28 (A)(1) of the 1997 NIRC which imposes the 34% regular corporate income tax rate on resident foreign corporations in general. This Court *en banc* cannot allow such act because it is contrary to law and jurisprudence as shown hereunder.

Petitioner's prayer for the imposition of the 34% regular corporate income tax rate, in effect, changes the terms of the assessment notice issued against the respondent which is a clear violation of Sec. 228 of the NIRC. Said provision requires that should the Commissioner of Internal Revenue or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings and that the taxpayer shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.

The respondent was informed that the assessment against it was based on its alleged liability for the 10% final tax on income derived from dealings with foreign currency transactions with residents pursuant to Sec. 28 (A)(7)(b) and Revenue Regulations No. 10-98. Consequently, its defense in its protest letter and during the trial in the Court in Division focused on its non-liability to the 10% final tax imposed by Sec. 28 (A)(7)(b) and Revenue Regulations No. 10-98. Changing the basis of the assessment in the Memorandum stage of the trial or as respondent alleges "in this Petition, Petitioner for the first time seeks an alternative relief"[5] cannot be allowed as this would constitute a denial of due process for the respondent herein pursuant to the mandatory provisions of Sec. 228 of the NIRC.

In addition, the doctrine laid down in *Aguinaldo Industries Corp. Fishing Nets Division v. Commissioner of Internal Revenue, et al., L-29790, Feb. 25, 1982* (112 SCRA 136) is applicable in petitioner's case, thus:

> "To allow a litigant to assume a different posture when he comes before the Court and challenge the position he had accepted at the administrative level, would be to sanction a procedure whereby the Court – which is supposed to review administrative determinations – would not review, but determine and decide for the first time, a question not raised at the administrative forum."

As previously stated, petitioner had admitted that the assessment was based on respondent's liability for the 10% final tax on the income

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5 Comment/Opposition to Petition For Review, p. 4.

derived from foreign currency transactions with residents and not on its liability for the 34% corporate income tax imposed under Sec. 28 (A)(1) of the 1997 NIRC on resident foreign corporations. Fairness dictates that if the ruling in the above-cited *Aguinaldo Industries* case applies to taxpayers, the same ruling shall likewise be applied with equal force and effect against the Commissioner of Internal Revenue.

Moreover, Sec. 203 of the 1997 NIRC provides that the petitioner should make the assessment within three years from the filing of the return. Section 203 provides:

> "**SEC. 203. Period of Limitation Upon Assessment and Collection.** — Except as provided in Section 222, internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period: Provided, That in a case where a return is filed beyond the period prescribed by law, the three (3)-year period shall be counted from the day the return was filed. For purposes of this Section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day."

It is clear from the afore-quoted provision that petitioner has only three (3) years within which to make an assessment for deficiency taxes and that no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period. Hence, allowing the petitioner to change the basis of the assessment only now or at this stage of the proceedings cannot be permitted because petitioner's right to assess the respondent for deficiency taxes for its 1998 income had long prescribed. And as provided under Sec. 203 of the 1997 NIRC, a proceeding for the collection of a tax cannot be had without a prior assessment having been duly issued for such deficiency tax and this is exactly what the petitioner is trying to achieve in this appeal. In fine, petitioner's alternative prayer is not allowed under the 1997 NIRC.

WHEREFORE, finding no cogent reason to disturb the findings and conclusions reached by the Court in Division in the assailed Decision dated May 17, 2005 as well as in the assailed Resolution dated August 16, 2005, the same are hereby **AFFIRMED**. Accordingly, the instant Petition for Review filed with the Court *en banc* on September 20, 2005 is hereby **DISMISSED** for lack of merit.

SO ORDERED.

JUANITO C. CASTAÑEDA, JR.,
Associate Justice

We Concur:

ERNESTO D. ACOSTA
Presiding Justice

LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution, it is hereby certified that the above Decision has been reached in consultation with the members of this Court before the case was assigned to the writer of the opinion of the Court.

ERNESTO D. ACOSTA
Presiding Justice