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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

CHINA BANKING CORPORATION,
Petitioner,

- versus - C.T.A. CASE NO. 2984

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

1/27/89

D E C I S I O N

This is an appeal by petitioner from the decision of respondent Commissioner of Internal Revenue dated June 13, 1978 holding petitioner liable for deficiency income tax in the amount of P517,475.47 for the year 1973.

Petitioner is a commercial banking corporation duly organized and existing in accordance with laws of the Philippines, with main office at Dasmarinas Corner Juan Luna Street, Manila; while respondent is the Commissioner of Internal Revenue and may be served with summons and other legal processes at the B.I.R. Building, Quezon City, Metro Manila.

(Petition, admitted in par. 1, Answer, pp. 1 and 53, CTA rec.)

By virtue of a Letter of Authority No. 34297 dated April 26, 1974, the Commissioner of Internal Revenue issued in favor of Revenue Examiner Antonio Aguilar an authority to investigate petitioner's books of account and other accounting records for all internal revenue taxes covering the years 1973 and all unverified prior years. (p. 3, BIR, rec.) After the termination of the said investigation, said Examiner Aguilar prepared and submitted a memorandum report addressed to the Commissioner of Internal Revenue dated June 10, 1974 recommending that a notice of assessment be sent to the taxpayer for a deficiency income tax in the amount of P616,418.12 for the year 1973. (p. 45, BIR rec.) Likewise, the Chief of Financing, Real Estate and Transfer Tax Division, Aquilino T. Larin, in his 1st Indorsement dated August 13, 1974 (p. 46, BIR rec.) addressed to the Commissioner of Internal Revenue, requested that a letter of assessment and demand be sent to the taxpayer in the amount of P517,475.47 as deficiency percentage tax covering the year 1973.

On the basis of the aforesaid recommendations, respondent Commissioner of Internal Revenue on September 9, 1974 issued a formal letter of assessment to the petitioner in the amount of P633,897.05 for deficiency income tax, as well as deficiency 5% Bank tax in the amount of P517,475.47 for the year 1973. (See Annexes A, A-1 and A-2, pp. 11-13, CTA rec.; see also par. 2, petition, admitted in par. 2, Answer, pp. 1 and 53 CTA rec.) computed as follows:

1973

Net income per return	P23,268,606.32
Add: Unallowable deduction:	
Over-claimed interest	
expense	1,721,038.48
Net income per investigation . . .	P24,989,644.80
Income tax due thereon	P 8,736,375.00
Less: Income tax due per return .	8,134,012.00
B a l a n c e	602,363.00
Add: 14% int. per annum fr.	
4-25-74 to 9-10-74	31,624.05
TOTAL AMOUNT DUE AND COLLECTIBLE .	P 633,987.05

xxx xxx xxx

Interest income per investigation.	P 8,278,807.61
5% bank tax due thereon	413,940.38
Add: 25% surcharge	103,485.09
Compromise penalty	50.00
TOTAL AMOUNT DUE AND COLLECTIBLE .	P 517,475.47

These assessments were timely protested by the petitioner in its letter dated October 10, 1974 praying that a reinvestigation of said assessment be granted on the following ground, to wit: (1) that it did receive the usual 10 days notice which is procedural before an assessment could be issued which was not followed by the respondent in this case; (2) that all interest expense deductions reported in its Income Tax Return for 1973 were legally incurred and duly paid; (3) that petitioner was not appraised of the sources and how the amounts in the assessment was arrived by the respondent.

As regards interest income from PW, ED, DBP and NPC bonds which are completely tax exempt should not be subject to 5% tax and income tax. Interest income from Central Bank Certificates of Indebtedness and Dividends received from private corporations should not have been included in the computation as basis for the 5% bank tax on gross receipts inasmuch as the corresponding taxes thereon were already paid by the Bank. (Annex B, pp. 14-16, CTA rec.)

On June 13, 1978, respondent Commissioner of Internal Revenue rendered a decision allegedly received by petitioner on November 14, 1978. This letter decision eliminated the 5% Bank tax amending and superseding the original assessment dated September 9, 1979, by means of issuance of an Amended Income Tax Assessment Notice No. 34-4-700067-73 reducing the income tax liability of the petitioner from P633,987.05 to P526,909.46 (Annex C and C-1 p. 17, CTA rec.), computed as follows:

Net income per return	P23,268,606.32
Add: Unallowable deduction Over-claimed interest expenses	1,060,181.39
Net income per re-investigation .	P24,328,787.00
Tax due thereon	P 8,505,075.00
Less: Amount paid	8,134,012.00
Deficiency tax	P 371,063.00
Add: 14% annual int. fr. 4-25-74 to 4-25-78	155,846.46
TOTAL AMOUNT DUE	P 526,909.46

In view of the aforesaid decision, petitioner on December 9, 1978 interposed its appeal to this Court by way of petition for review. Respondent Commissioner of Internal Revenue on June 13, 1979, filed his answer to the said petition setting up the following Special and Affirmative Defenses, to wit:

SPECIAL AND AFFIRMATIVE DEFENSES

Respondent respectfully alleges -

8. That petitioner, just like other banks, purchased tax-exempt government bonds out of its conglomerated funds consisting of time, savings, demand, margin deposits, capital and other sources of funds;

9. That interest-bearing bank deposits (time and savings) are in the nature of borrowed funds which banks have the obligation to return with earned interest to depositors;

10. That income from investment in tax-exempt government bonds are tax-exempt and said investment can also serve as part of legal reserve against deposit liabilities;

11. That since the income from investment in tax-exempt government bonds with interest-bearing deposits is tax exempt, it follows that interest on said deposits paid by petitioner to depositors are not deductible interest-expense under Sec. 30(b) (1) of the Tax Code, as amended and it is a well-established principle that tax exemption provisions, being a legislative grace and highly desfavored by law, should be construed strictly against the taxpayer. To hold otherwise would allow petitioner to enjoy interest-expense deduction on interest-bearing deposits used to purchase tax-exempt government bonds the earnings of which are already tax-exempt, thus, resulting in double tax exemption privileges;

12. That contrary to the mistaken notion of petitioner, respondent did not actually disallow the whole sum invested

in tax-exempt government bonds (as all interest-bearing deposit liabilities) but only the interest-expense on interest bearing deposits used to purchase said bonds; interest bearing deposits (savings and time) constitute only a portion of the funds used to purchase tax-exempt government funds; hence, the necessity of a formula of allocation;

13. That during the investigation of the tax in question, it was ascertained that petitioners' funds which flowed from different sources (time, savings, demand, margin deposits, capital, etc.) were conglomerated and that it was not possible to identify the particular funds used to purchase tax-exempt government bonds; hence, the use of aforesaid reasonable formula to allocate the interest bearing funds invested in tax-exempt government funds;

14. That Central Bank Circular No. 93 dated February 2, 1952 requires that 5% of saving and time deposits (interest bearing) must be deposited by banks in cash with the Central Bank as legal reserve to protect their depositors but the whole of this 5% may be invested in government tax-exempt bonds instead of in cash;

15. That since the said 5% legal reserve requirement for interest bearing deposit liabilities (time and savings) may be in the form of investment in tax-exempt government bonds instead of the usual cash deposited with the Central Bank, it is for the best interest of petitioner to invest the whole 5% of interest bearing deposit liabilities (savings and time) in tax-exempt government bonds which earns interest-income and at the same time serve as

legal reserve instead of just depositing the same with the Central Bank in cash as reserve;

16. That in computing its net taxable income involved in this case, petitioner deducted from its gross income the total amount of P15,490.89.46 as interest-expense, of which amount respondent disallowed only P1,060,041.90 representing interests paid on deposits used to buy tax-exempt government bonds under the provision of Sec. 30(b)(1) of the Tax Code, as amended; and

17. That the tax assessment in this case is in accordance with existing laws and regulations on the matter.

The records show that this case was submitted for decision by the Court upon motion of counsel for respondent (see p. 88, CTA rec.), without the parties having presented evidence on the merits of this case. Neither did the parties submitted memoranda in support of their respective contentions.

As we have said, since the original assessment has been superseded and amended, and that the 5% Bank tax having been eliminated, the only remaining issue now posed before this Court for resolution is whether or not the deduction claim in the amount of P1,060,181.39 as interest expense in its income tax for the year 1973 is allowable.

The provision of the law applicable on the case at bar is Section 30(b)(1) of the Tax Code which we hereby quote below as follows:

> Sec. 30. Deduction from gross income -
>
> xxx xxx xxx
>
> (b) Interest:
>
> (1) In general - The amount of interest paid within the taxable year on indebtedness, except on indebtedness incurred on continued to purchase or to carry obligations the interest upon which is exempt from taxation as income under this title.

The law seems clear and specific. It merely calls for its application as worded. The general rule is interest paid within the taxable year on indebtedness is an allowable deduction from the gross income. However, the exception is in those cases were the taxpayer incurred indebtedness on the purchase of or to carry obligations the interest of which is exempt from taxation, then such interest expense incurred is not a deductible expense.

Going back to the instant case, it is not denied by petitioner that it did purchase tax-exempt government bonds and securities. (par. 8, Petition) Definitely, on the basis of the above quoted provision of the law, it cannot now claim that interest on deposits used to purchase tax-exempt government bonds and securities are interest expense and should therefore be allowable. To adhere to petitioner's contention would, in effect, allow the petitioner to enjoy interest expense deduction on interest-bearing deposit used to purchase tax exempt government bonds and securities, the earning of which are already tax-exempt, resulting on the double tax-exemption privileges.

Settled is the rule in this jurisdiction, that statutes must be strictly construed against the one claiming the exemption because the law does not look with favor on tax exemption and that he who would seek to be thus privileged must justify it by words too plain to be mistaken and too categorical to be misinterpreted. ***(Philippine Bank of Communication vs. Commissioner of Internal Revenue,*** *CTA Case No. 2725, January 6, 1988; citing* ***Commissioner of Internal Revenue vs. J.P. Kiener Co., Ltd.,*** *G.R. No. L-24754, July 18, 1975, 65 SCRA*

*142; **Union Garment, Inc., vs. Court of Tax Appeals**, G.R. No. 16809, January 31, 1962, 4 SCRA 304; **Commissioner of Internal Revenue vs. Guerrero**, G.R. No. L-20942, September 22, 1967, 21 SCRA 180; **Republic Flour Mills Inc. vs. Commissioner of Internal Revenue**, G.R. No. L-25602, February 18, 1970, 31 SCRA 520.)*

Petitioner claims further that respondent disregarded the Bureau's ruling decision dated November 16, 1969 which at the time was the prevailing ruling or doctrine on the matter. The records show that this is merely an allegation of the petitioner which is not substantiated by evidence. As we have said, this case was submitted for decision to the Court without the parties availing of their rights to present their evidence in support of their respective stand.

Likewise, petitioner also claims that no formal or informal hearing in connection with its request for reconsideration of said assessment was had before the Bureau, and that the ten (10) days notice before the issuance of assessment was not received by it thus depriving the petitioner the due process of law. We find this contention without merit. It is worth to note that the hearing before this Court is in the nature of a trial *de novo*, where parties are given all the opportunies to present their respective evidence in support of their case and since petitioner did not avail of such an opportunity, it cannot now claim that it has been deprived of the due process of law. Definitely, this Court finds no alternative but to sustain the presumption of correctness of the assessment in question.

To state a well settled rule, it is incumbent upon the taxpayer to show clearly that the assessment is erroneous in order to relieve himself from it, for it is a established principle in taxation that an assessment issued by respondent Commissioner is prima facie correct, and as such it is incumbent upon the taxpayer to overcome such a presumption of correctness. Furthermore, the taxpayer must show that the claimed deduction comes within the language of the law, since deductions, like exemptions, are matters of legislative grace. ***(Daiichi Chuo Kisen Kaisha vs. Comm. of Int. Rev.,*** *CTA Case No. 1277, May 31, 1969; Corporacion de PP. Augustinos vs. Comm. of Int. Rev., CTA Case No. 1735, May 29, 1970.)*

We are therefore of the opinion that petitioner is liable for deficiency income tax covering the year 1973 computed as follows:

Net income per return	P23,268,606.32
Add: Unallowable deduction Over-claimed interest expense	1,060,181.39
Net income per re-investigation	24,328,787.00
Tax due thereon	8,505,075.00
Less: Amount paid	8,134,012.00
Deficiency tax	371,063.00
Add: 14% annual int. fr. 4-25-74 to 4-25-78	155,846.46
TOTAL AMOUNT DUE	P 526,909.46

WHEREFORE, petitioner China Banking Corporation is hereby ordered to pay the respondent Commissioner of Internal Revenue, the sum of P526,909.46 as deficiency income tax for 1973, inclusive of delinquency interests, plus 5% surcharge, at the rate of 14% per annum from June 13, 1978 ntil it is paid, provided that the maximum amount that be collected as interest on the delinquency shall in no case exceed the amount corresponding to three (3) years pursuant to

Section 51(e)(2)(3) of the Tax Code, as amended by P.D. No. 69.

SO ORDERED.

Quezon City, Metro Manila, January 27, 1989.

CONSTANTE C. ROAQUIN
Associate Judge

WE CONCUR:

AMANTE FILLER
Presiding Judge

ALEX Z. REYES
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.

AMANTE FILLER
Presiding Judge
Court of Tax Appeals