REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PHILIPPINE BANK OF COMMUNICATIONS,
Petitioner,

- versus -

C.T.A. CASE NO. 5251

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
NOV 17 1999

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DECISION

This is a petition seeking for the cancellation and withdrawal of the deficiency income and onshore tax assessments issued by the Bureau of Internal Revenue (BIR) against herein Petitioner for the taxable years 1988 and 1989 totalling P28,230,174.70.

The facts of the case are as follows:

Petitioner is a corporation duly organized and existing under and by virtue of Philippine laws. It is engaged in commercial banking activities as regular banking unit and as an expanded foreign currency deposit unit.

On August, 1993, Petitioner received from the BIR assessment notices bearing Assessment Numbers FAS-2-88-93-002862, FAS-2-88-93-002863, FAS-2-89-93-002864 and FAS-2-89-93-002865, all issued on July 27, 1993 and demanding payment from Petitioner for alleged deficiency income tax and onshore tax for the years 1988 and 1989 in the amounts of P11,060,056.92, P425,616.18, P16,259,617.67 and P485,883.93, respectively (Exhibits A to D).

The assessment against Petitioner for deficiency income tax for the year 1988 resulted from the disallowance of a bad debts deduction it had claimed amounting to P11,000,000.00 as well as its claim for deduction of a documentary stamp tax payment in the amount of P2,585,450.04. For the year 1989, the assessment for deficiency income tax likewise resulted from the disallowance of Petitioner's bad debts deduction amounting to P20,546,236.02 and an alleged miscellaneous expense of P1,844,500.00.

Upon the other hand, the deficiency onshore tax assessments against Petitioner for the years 1988 and 1989 arose from its alleged failure to pay the 10% tax imposed by Section 24(e)(3) of the Tax Code on interest income it had derived from its foreign currency denominated loan to the Light Rail Transit Authority (LRTA) amounting to P1,768,967.20 in 1988 and P2,260,058.40 in 1989.

Through a letter dated August 16, 1993, Petitioner protested the aforesaid assessments and requested that the same be reconsidered and/or withdrawn (Exh. F). The protest, however, was denied with finality by Respondent through a letter dated March 8, 1995 and received by Petitioner on April 7, 1995 (Exh. G). And so, on May 5, 1995, the instant petition was filed by the latter praying for the cancellation and withdrawal of its deficiency income tax and onshore tax assessments for the years 1988 and 1989 in the total amount of P28,230,174.70.

In the course of the trial, Petitioner presented witnesses and documentary evidence to controvert the bases for Respondent's assessments and thereafter filed through registered mail its Formal Offer of Evidence on December 18, 1997 which was admitted by the Court on March 19, 1998 (p. 341, CTA records). On the other hand, counsel for the Respondent manifested during the hearing on April 29, 1998 that there is no need to present any evidence considering that the issue involved in this case is purely legal (p. 348, CTA records).

The Court then required the parties to submit their memoranda. Respondent obliged on June 15, 1998. Petitioner, however, filed on July 1, 1998 an "Urgent Motion to Defer Submission of Memorandum and Leave of Court to Allow Petitioner to Present Additional Evidence" which was granted by this Court on July 15, 1998. The following additional evidence were presented by Petitioner:

Exhibits	Description
W	Waiver of the Defense of Prescription under the Statute of Limitations of the National Internal Revenue Code dated September 7, 1992.
X	Waiver of the Defense of Prescription under the Statute of Limitations of the National Internal Revenue Code dated March 16, 1993.
Y	Petitioner's Corporation Annual Income Tax Return for the calendar year 1988.
Z	Petitioner's Corporation Annual Income Tax Return for the calendar year 1989.

Respondent objected to the admission of the aforesaid exhibits on the ground that said exhibits were offered mainly to prove that the right of the government to assess has prescribed and since prescription was not raised in the pleadings, any evidence offered to prove that the right to assess has prescribed would be irrelevant, hence, inadmissible.

The Court ruled in favor of Respondent and denied the admission of the additional exhibits offered by Petitioner. Thus, Petitioner, on October 9, 1998, filed a "Motion for Leave of Court to Amend Petition for Review to Conform to Evidence" with an attached "Amended Petition for Review".

According to Petitioner, the allowance by the Honorable Court of an amendment of the petition for review to conform the same to the evidence presented (Exhibits "W" to "Z", inclusive of sub-markings) will serve the interest of justice and equity in the light of the following circumstances: (1) the defense of prescription that arises from the invalidity of the Waivers (Exhibits "W" and "X") could not have been foreseen by petitioner during the filing of the protest or the petition for review considering that the said waivers were presumably valid at the time of their execution. At the time the petitioner executed and filed the subject waivers until the inadvertent discovery of their invalidity, the petitioner had been precluded from raising the defense of prescription because of its reliance in good faith that "that official duty has been regularly performed" {Rule 131 Section 3(m)] by the Commissioner of Internal Revenue, i.e., the signing of the waivers pursuant to Revenue Memorandum Circular 20-90; and (2) the infirmity in the Waivers from which the defense of prescription arose was only made known to the petitioner during the pendency of the case when said infirmity was inadvertently discovered by petitioner's counsel after a careful examination of the BIR records (BIR records, page 240 and 241, respectively) that precedes the preparation of his memorandum.

The said Motion of Petitioner was granted on December 4, 1998 and the attached Amended Petition for Review was duly admitted.

In his Answer, Respondent raised the following Special and Affirmative Defenses:

"11. The assessment is valid and correct and the taxpayer has the burden of proof to impugn its validity (Belen Meyer & Co., vs. Collector of Internal Revenue, 27 Phil. 657). Petitioner miserably failed to present concrete evidence to overcome the presumption of validity and correctness attached to the assessment.

12. The Assessment was made in accordance with law based on facts, as a result of the investigation conducted against petitioner by the revenue officer of respondent.

13. Bad Debts is proper when it is ascertained to be worthless and actually charged off within the taxable year when it is determined to be worthless (Section 29(e), Tax Code). The said losses or bad debts must be ascertained to be so and written off during the taxable year. Therefore, they are deductible in full or not at all, in the absence of any express provision in the Tax Code authorizing partial deductions (Fernandez Hermanos, Inc., vs. CIR, 29 SCRA 533). Thus, there cannot be partial writing off of a loss or bad debts.

14. Bad debts are allowed as deductions in the year when ascertained to be worthless and not at the time when the taxpayer may finally "give up" on the possibility of recovering any part of the debts and decide to charge them off (CCH, 60 Vol. 2, p. 21.00); page 252, updated National Internal Revenue Code with notations and appendices, 1988 Edition, Jose Aranas).

15. The taxpayer must take reasonable steps to collect the debt. He does not have to go to Court if it can be shown that judgment once obtained would be worthless because the debtor is insolvent or "judgment proof". If, in the exercise of sound business judgment a taxpayer believes there is no likelihood of recovering at any time in the future, the debt has been worthless (Western Pacific Corporation vs. Collector of Internal Revenue, CTA Case No. 720).

16. Compromise payment arising from non-payment/affixture of documentary stamp tax is not deductible from gross income (Section 29(c)(1), Tax Code). Deductible "taxes" means taxes proper and no deduction should

be allowed for amounts representing interest, surcharge, or penalties incident to delinquency (Section 80, Revenue Regulations No. 2).

17. Income tax is not allowable as deduction from the gross income for income tax purposes either as taxes and licenses, or miscellaneous expenses (Section 29(c)(1), Tax Code).

18. Interest income from foreign currency loans granted by depositary banks under the Expanded Foreign Currency Deposit 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% onshore tax (Section 25(a)(6)(B), Tax Code).

19. Prescription does not lie if there is an agreement between the petitioner and respondent to suspend the running of the prescriptive period thereby extending the limitations prescribed by law (Section 223(b), Tax Code)."

The primordial issue for consideration is whether or not the right of the government to assess has prescribed. If not, is Petitioner liable for the alleged 1988 and 1989 deficiency income and onshore tax assessments?

Section 203 of the 1988 National Internal Revenue Code provides:

Section 203. ***Period of limitation upon assessment and collection.*** - Except as provided in the succeeding section, internal revenue taxes shall be assessed within three 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 case where the return is filed beyond the period prescribed by law, the three year prescriptive period shall be counted from the day the return was filed. For the 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.

The above rule, however, is not absolute. Under Section 223 of the same Code,

> "(b) If before the expiration of the time prescribed in the preceding section for the assessment of the tax, both the Commissioner and the taxpayer have agreed in writing to its assessment after such time, the tax may be assessed within the period agreed upon. The period so agreed upon may be extended by subsequent written agreement made before the expiration of the period previously agreed upon."

For purposes of clarity, We shall discuss Petitioner's 1988 and 1989 deficiency income and onshore tax assessments separately.

Petitioner filed its 1988 Annual Income Tax Return on April 12, 1989 (Exh. "Y", p. 57, BIR records). Since the last day for filing the return under Section 70 of the Tax Code is April 15, 1989, the BIR has three years from the said date or until April 15, 1992 within which to assess. Hence, since the assessments were issued on July 27, 1993, verily, the waivers executed by Petitioner on September 7, 1992 covering the latter's 1988 income tax liabilities (Exh. "W") and on March 16, 1993 (Exh. "X") covering both its 1988 and 1989 internal revenue tax liabilities were rendered of no effect as there was nothing more to extend at the time they were executed. The right of the government to assess Petitioner for its 1988 deficiency income and onshore tax assessments issued by Respondent against Petitioner has prescribed long before the execution of the said waivers.

We proceed to Petitioner's 1989 deficiency income tax assessment covered by Assessment No. FAS-2-89-93-002864 in the amount of P16,259,617.67.

Petitioner filed its 1989 Annual Income Tax Return on April 11, 1990 (Exh. "Z", p. 86, BIR Records) and so, the BIR has until April 15, 1993 to assess. As mentioned earlier, on March 16, 1993, Petitioner executed a waiver consenting to the assessment and/or collection of the taxes which may be found due after investigation at any time before or after the lapse of the period of limitations fixed by Sections 203 and 223 of the NIRC but not later than September 30, 1993. It would seem, therefore, that the BIR's right to assess was extended by the said waiver. An examination, however, of the waiver would reveal the absence of the signature of the Commissioner, whose signature is required in waivers for tax cases involving more than one million pesos under Revenue Memorandum Order No. 20-90. The subject waiver was instead signed by Mr. Bernardo A. Frianeza, the Assistant Revenue Service Chief, Special Operations Service, of the BIR. Since the amount involved in Assessment No. FAS-2-89-93-002864 is P16,259,617.67, the waiver was invalid insofar as the said assessment was concerned and consequently did not suspend the running of the three-year prescriptive period. Thus, when Respondent issued the aforesaid assessment on July 27, 1993, his right to assess has prescribed.

Nonetheless, this Court believes that the waiver is valid insofar as Assessment No. FAS-2-89-93-002865 is concerned. This assessment covering Petitioner's 1989 Deficiency Onshore Tax is only for the amount of P485,883.93 and so the Assistant Revenue Service Chief may validly sign a waiver extending the period to assess pursuant to Revenue Memorandum Order No. 20-90 which provides in part, thus :

3. The following revenue officials are authorized to sign the waiver

A. In the National Office

1. ACIRs for Collection, Special Operations, National Assessment, Excise and Legal on Tax Cases	-	For tax cases involving not more than P500,000.00

Anent this assessment, Petitioner contends that an onshore tax is in the nature of a final withholding tax which is to be withheld by the domestic borrower pursuant to Section 50(a) of the Tax Code, in relation to Section 24(e)(3), to state:

> "(3) Tax on income derived under the Expanded Foreign Currency Deposit System. - x x x: Provided, That interest income from foreign currency loans granted by such depository bank 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 10% tax."
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> "Sec. 50 (a) Withholding of final tax on certain incomes.- The tax imposed or prescribed by Sections x x x, 24(e)(1), (e)(2)(B), (e)(3); x x x of this Code on specified items of income shall be withheld by payor-corporation and/or person and paid in the same manner and subject to the same conditions as provided in Section 51 of the National Internal Revenue Code, as amended."

According to Petitioner, the obligation to withhold and remit the 10% onshore tax devolved upon the LRTA as borrower and the payor of the interest income on the onshore loan, notwithstanding its alleged tax exempt status. Petitioner further argues that the LRTA had assumed the liability for the payment of the taxes otherwise imposable on its borrowings from Petitioner.

Respondent, on his part, contends that pursuant to Section 25(a)(6)(B) of the Tax Code, interest income from foreign currency loans granted by depository banks under the Expanded Foreign Currency Deposit 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 and since the 10% onshore tax is an income tax imposed on the interest income and not on the interest expense, it should be paid by the lender who receives the interest, not by the borrower who pays the interest.

We find against Petitioner.

While Petitioner maintains that the obligation to withhold and remit the 10% onshore tax devolved upon the LRTA and that the LRTA had assumed the liability for the payment of the taxes, there was no showing that the LRTA had indeed withheld and paid the taxes due. There was no proof of grossing up of payments as alleged by Petitioner. The corresponding Certificate of Tax Withheld was not presented. In fact, Petitioner, in its Schedule of Onshore and Offshore Income and the Corresponding Income Tax for the year ended December 31, 1989 (p. 76, BIR records), reflected the subject income as tax exempt income. Hence, there is a plain indication that the tax due on the income from the loan was not paid. The terms of the agreement between Petitioner and LRTA likewise did not clearly show that there was indeed an assumption of liability on the part of LRTA. What is more evident to us is that the interest income earned by Petitioner is subject to 10% onshore tax which Petitioner failed to prove the fact of withholding and payment.

WHEREFORE, in the light of all the foregoing, Assessment Numbers FAS-2-88-93-002862, FAS-2-88-93-002863 and FAS-2-89-93-002864 are hereby **CANCELLED** and **WITHDRAWN** for having been issued out of time. Petitioner, however, is hereby **ORDERED** to **PAY** to Respondent the amount of P480,883.93 as deficiency onshore tax for the year 1989, plus 20% interest per annum from the date prescribed for payment until its full payment pursuant to Section 249 of the National Internal Revenue Code. The compromise penalty of P5,000.00 is cancelled due to the absence of an agreement freely entered into between Petitioner and Respondent (Collector of Internal Revenue v. UST, G.R. L-11274 and L-11280, Nov. 28, 1958; MR Arick v. Comm., CTA 1679, May 30, 1969, cited in Industrial Inspection (Int'l.) Incorporated v. Liwayway Vinzons Chato, CTA Case No. 5152, May 19, 1997).

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

RAMON O. DE VEYRA
Associate Judge

AMANCIO Q. SAGA
Associate Judge

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Judge