REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

CITYTRUST INVESTMENT PHILIPPINES, INC. (formerly Citicorp Investment Philippines, Inc.),
Petitioner,

- versus - C.T.A. Case No. 4443

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

x - - - - - - - - - - - - - - - - - x

1/18/94

DECISION

In this case, petitioner Citytrust Investment Philippines, Inc. comes before this Court praying for the nullification of the assessment covering its alleged deficiency income tax for the taxable year 1982.

The facts of this case are briefly as follows:

Respondent Commissioner of Internal Revenue issued assessments against petitioner dated July 30, 1987 which were received by the latter on August 4, 1987. The assessments were for deficiency income tax, deficiency documentary stamp tax, deficiency expanded withholding tax, and deficiency withholding tax on interest expense, all for the taxable year 1982.

In a letter dated August 15, 1987 received by respondent on August 25, 1987, petitioner protested the assessments. Another protest-letter of September 11, 1988 was filed before the respondent on September 15, 1988.

Respondent, on March 20, 1990 issued her final decision on the matter. In her decision, the assessments involving deficiency documentary stamp tax and deficiency withholding tax on interest expense were cancelled while the assessments regarding deficiency income tax and deficiency expanded withholding tax were modified as follows:

1982 Deficiency Income Tax

Deficiency income tax	₱424,114.00
Add: 20% interest per annum(60% max.)	254,468.55
Total amount due and collectible	₱678,582.55

1982 Deficiency Expanded Withholding Tax

Deficiency expanded withholding tax	₱ 9,733.68
Add: 25% Surcharge	2,433.42
20% interest per annum (1-25-83 to 1-25-89)	7,786.94
Compromise penalty	1,000.00
Total amount due and collectible	₱ 20,954.04

Petitioner, in its bid to lessen its liability, offered to settle by way of a compromise the deficiency income tax. It proposed to pay ten (10%) *per cent* of the basic tax or the amount of P42,411.40. Thereafter or on April 27, 1990, petitioner paid the amount of P20,954.04 as deficiency expanded withholding tax.

Without awaiting any reply from the respondent with regard to the proposed compromise settlement, petitioner on April 18, 1990 filed before this Court this instant petition for review. It is now questioning the validity of the P678,582.55 deficiency income tax assessment.

Before this Court for determination is the issue of whether or not petitioner is liable for the additional income tax resulting from the disallowance of expenses allocable to incomes arising from interest and reversal of overprovision in prior years of allowance for probable losses.

Respondent claims that petitioner, having derived its gross income both taxable and non-taxable in 1982, declared only in its income tax return the income which is taxable but nevertheless, claimed as deductions all the expenses it had for the taxable year. She determined the portions of said expenses which correspond to the incomes not subject to ordinary income tax and disallowed the same thus resulting to the deficiency income tax assessment.

In disallowing the amount of P1,211,755.55 as deductible expenses, respondent computed the ratio of incomes not subject to ordinary income tax as against the corporation's gross income amounting to P47,818,774.00. She totalled the following:

Interest on savings account	P 60,595.00
Interest earned on government securities	833,063.00
Interest earned on trust placement	863,542.00
Reversal of overprovision in prior years of allowance for probable losses	256,417.00
T o t a l	P2,013,617.00

The basic deficiency income tax was arrived at based on the computation as shown below: (B.I.R. Records, p. 109)

Income not subject income tax x Total Expenses x Tax rate
Gross income

P 2,013,617.00
P47,818,774.00 x P32,975,566.00 = P1,211,755.55*
x 35%

Deficiency income tax P 424,114.00

* Should be P1,388.579.29

The Court finds for the petitioner.

As previously discussed, respondent totalled the incomes not subject to regular income tax and disallowed the expenses allocated to them. She considered interest incomes as non-taxable incomes unmindful of the fact that under Section 24(cc) of the Tax Code then, interest incomes were subject to a final tax.

Prior to 1980, the prevailing law is Presidential Decree (P.D.) No. 1156 which was promulgated on June 3, 1977 mandating for the withholding of tax on interest income on bank deposits. At that time, interest income was included in the computation of gross income.

Former Commissioner Efren Plana said on the reason for withholding tax on interest income arising from bank deposits:

> "The circumstances that led to the imposition of the tax on interest on deposit substitutes also led to the promulgation of PD No. 1156. Despite the fact that interest income is taxable, many individual depositors failed to report their interest income from their bank deposit accounts in their income tax returns. The confidential nature of bank deposits has practically barred the B.I.R. from effectively enforcing the income tax law on these types of taxable income resulting in revenue losses. In order to collect income tax on interest income which was heretofore undeclared, it was decided to require banks to withhold for the government the tax on interest on deposit accounts without disclosing the names of depositors and the amounts of their deposits. The confidential nature of bank deposits is absolutely maintained." (Nolledo and Nolledo, the National Internal Revenue Code, 1993 16th and Revised Ed., p. 430)

On September 17, 1980, P.D. No. 1739 was enacted changing the nature of the withholding tax from creditable to final tax. It provides:

> "SEC. 3. Section 24 of the same Code is hereby amended by adding a new subsection (cc) between subsections (c) and (d) to read as follows:
>
> (cc). *Rates of tax on interest from deposits and yield from deposit substitutes.* - Interest on Philippine Currency bank deposits and yield from deposit substitutes received by domestic or resident foreign corporations shall be subject to a <u>final tax</u> on the total amount thereof as follows: (a) 15% of the interest on savings deposits; and (b) 20% of the interest on time deposits and yield from deposit substitutes which shall be collected and paid as provided in Sections 53 and 54 of this Code: *Provided*, That if the recipient of such interest is exempt from income taxation, no tax shall be imposed and that, if the recipient is enjoying preferential income tax treatment, then the preferential tax rates so provided shall be imposed."(Underscoring supplied)

The respondent, on November 7, 1980 issued Revenue Regulations No. 12-80, as amended providing for the final withholding income tax on bank deposits. Section 3(a) of the Regulations reads as follows:

> "SEC. 3. *Imposition of Tax.* - The following taxes on income shall be imposed:
>
> *(a) Final withholding income tax on -*
>
> *(1) Interest on saving deposit.* - In general, the rate of final withholding tax to be imposed on savings deposit maintained with authorized agent bank shall be fifteen (15%) per cent based on adjusted gross interest

> paid or accured. However, where the recipient/depositor is enjoying preferential income tax treatment under existing laws, the withholding tax rate to be applied shall be the tax rate applicable to said class of taxpayers or to such type of income as shown in the certificate or preferential tax treatment issued by the Commissioner of Internal Revenue.
>
> xxx xxx xxx
>
> (2) *Interest on time deposit or yield on deposit substitute.* - In general, the rate of final withholding tax to be imposed on interest on time deposits by authorized agent banks and on yield on deposit substitutes by authorized agent banks and non-bank financial intermediaries shall be twenty per centum (20%). However, where the depositor/investor is enjoying preferential tax treatment under existing laws, the withholding tax rate to be applied shall be the tax rate applicable to the said class of taxpayer or to such type of income as shown in the certificate of preferential tax treatment issued by the Commissioner of Internal Revenue.
>
> xxx xxx xxx"

Classifying interest incomes as non-taxable incomes is a misnomer since income arising from bank deposits, government securities or trust placements are taxed separately under the Tax Code.

Furthermore, income from interest which is considered as passive and fixed income can be realized without the necessity of incurring expenses. In earning interest income, taxpayers need not spend for salaries, wages, commissions, management or professional fees, rental and other utilities, advertising and promotions, depreciation, supplies and the like. Normally, once the money is invested, there is nothing left for the taxpayers to do. The invested money will surely earn interest income. Consequently, there is no logical basis to allocate expense to this kind of income.

Likewise, reversal of overprovision in prior years of allowance for probable losses is merely an accounting entry which will not result to any tangible income on the part of the petitioner; thus, no expenses can be rightly allocated to it. In petitioner's financial statement, it noted that:

> "Allowance for Probable Losses - The Company provides allowance for doubtful accounts based on a review by management of the current status of all the existing receivable" (B.I.R. Records, p. 56).

Provision for probable losses, unlike bad debts written-off is not a deductible expense as far as computing the taxable income is concerned. Conversely, a reversal entry (overprovision) cannot be considered as income.

The incomes used by the respondent as bases for disallowance of expenses cannot justify her assessment. As explained above, no expenses can be rightly allocated to interest incomes and reversal of overprovision since they can be "earned" without the necessity of incurring expenses.

Having thus ruled, the other issues raised in this case have become moot and academic.

WHEREFORE, in view of all the foregoing, the assessment issued by the respondent against the petitioner for alleged deficiency income tax for taxable year 1982 is hereby **CANCELLED**. No pronouncement as to costs.

SO ORDERED.

Quezon City, Metro Manila, January 18, 1994.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

MANUEL K. GRUBA
Associate Judge

RAMON O. DE VEYRA
Associate Judge

CERTIFICATION

I hereby certify that the 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.

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals