REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

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PRUDENTIAL BANK,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 7380

Members:

ACOSTA, *Chairperson*
BAUTISTA, and
CASANOVA, *JJ.*

Promulgated:

JUL 04 2007, 2:10 pm

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DECISION

ACOSTA, PJ.:

Before Us is a Petition for Review seeking the cancellation and withdrawal of the Formal Letter of Demand/Assessment Notice (FAN) dated March 18, 2005. The subject FAN demands payment from petitioner of the amount of P18,440,427.16 and P19,280,776.04, allegedly representing deficiency Gross Receipts Tax (GRT) and Documentary Stamp Tax (DST), respectively, on petitioner's Foreign Currency Deposit Unit (FCDU) transactions during taxable year 1999.

Petitioner is a banking corporation organized and existing under and by virtue of the laws of the Republic of the Philippines with principal office at Prudential Bank Building, Ayala Avenue, Makati City[1].

Respondent Bureau of Internal Revenue (BIR), through the Commissioner of Internal Revenue, is the agency of the government tasked with the enforcement of revenue laws and the collection of taxes and duties, with principal address at the BIR National Office Building, Diliman, Quezon City.[2]

On October 13, 2004, petitioner received from respondent a Preliminary Assessment Notice (PAN) dated September 17, 2004 demanding payment of alleged deficiency GRT and DST on petitioner's FCDU transactions in the amounts of P17,765,655.57 and P18,576,920.81, respectively, inclusive of interest, surcharge and compromise penalty for taxable year 1999.[3]

Petitioner requested for the cancellation of the aforesaid PAN for lack of factual and legal basis by filing a position letter on October 26, 2004.[4]

On March 21, 2005, petitioner received from respondent a Formal Letter of Demand/Assessment Notice (FAN) dated March 18, 2005 demanding payment of deficiency GRT and DST on its FCDU transactions for taxable year 1999 in the amount of P18,440,427.16 and P19,280,776.04, respectively.[5]

On April 19, 2005, petitioner filed its administrative protest on the FAN alleging, among others, that its FCDU transactions are not subject to any kind of tax

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[1] Joint Stipulation of Facts and Issues, par. 1, Records, page 152.
[2] Joint Stipulation of Facts and Issues, par. 2, Records, page 152.
[3] Joint Stipulation of Facts and Issues, par. 3, Records, page 153.
[4] Petition for Review, Annex "B", Records, page 26.
[5] Joint Stipulation of Facts and Issues, par. 5, Records, page 153.

except for the 10% final tax under pertinent provisions of the National Internal Revenue Code (1997 Tax Code).[6]

However, due to respondent's inaction, petitioner filed the instant Petition for Review on November 29, 2005, pursuant to Section 228 of the 1997 Tax Code, as amended.

It is petitioner's position that despite the passage of the 1997 Tax Code, as amended, except for the 10% Final Income Tax, the exemption of Foreign Currency Deposit Units (FCDUs) from all other taxes remains. Tracing the supposed historical development of the statutes applicable to FCDU, petitioner explains that Presidential Decree (PD) 1035, as implemented by Revenue Regulations (RR) No. 10-76, subjects the income of FCDUs to 5% or 10% tax, depending on whether the income is onshore or offshore, "in lieu of all taxes". Similarly, when the 1977 Tax Code was passed, FCDUs income was exempted from all other taxes except those incomes from foreign currency loans granted to residents which were subject to the 10% tax, also "in lieu of all taxes". However, when the 1997 Tax Code was passed, the phrases "in lieu of all taxes" or "shall be exempt from all taxes" which can be found in PD 1035 and 1977 Tax Code, respectively, were not carried over.

Nonetheless, according to petitioner PD 1035 deals with income derived by FCDUs **from all sources** whereas the 1997 Tax Code deals only with **some items** of income derived by FCDUs. In other words, the 1997 Tax Code merely made distinctions as to the income and transactions of FCDUs that are taxable and non-taxable, but did not all together removed their tax exemption.

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[6] Petition for Review, Annex "D", Records, page 46.

Petitioner further asserts that the non-repeal of PD 1035 is supported by the fact that it was never the intention of the legislature to remove the tax exemption of FCDUs, as expressly mentioned during the deliberations of Republic Act (RA) No. 9294. The said law restored the tax exemption of FCDUs and OBUs in 2004. This being the case, petitioner also claims that R.A. No. 9294 should thus be given retroactive effect, being a curative statute, meant to correct the defect in the 1997 Tax Code.

Respondent filed his Answer on January 4, 2006. Respondent counters that the elimination of the phrase "exempt from all taxes" from the 1997 Tax Code is an explicit intention of the lawmakers to subject FCDUs to other taxes including GRT and DST and to repeal the "in lieu of all taxes" provision under RR No. 10-76 and PD 1035.

During the hearing held on October 3, 2006, the parties through their respective counsels moved for the submission of the case for decision based on the pleadings considering that it involve purely legal issues. The Court granted the said motion and likewise granted the parties a period of thirty (30) days to submit their Memoranda. The case was submitted for decision as of the promulgation of the Resolution on November 24, 2006.

The parties jointly submitted the following issues:

1. Whether or not petitioner's Foreign Currency Deposit Unit transactions are, save the 10% final tax, exempt from GRT, DST and all other kinds of taxes;
2. Whether or not respondent's assessment for year 1999 had already prescribed;

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3. Whether or not respondent's assessment notice is arbitrary and without factual basis.

After considering the attending facts, evidence, jurisprudence and laws applicable in this case, this Court resolves against petitioner.

Anent the issue of whether Foreign Currency Deposit Unit transactions are exempt from all kinds of taxes, except for the 10% Final Tax, this Court rules on the FCDUs taxability.

Prior to the amendment introduced by the 1997 Tax Code, **Section 25(1)(6)(B) of the 1977 Tax Cod**e provides:

> "(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 non-residents, offshore banking units in the Philippines, local commercial banks including branches of foreign banks that may be authorized by the Central bank of the Philippines to transact business with foreign currency depository system units and other depository banks under the expanded foreign currency deposit system **shall be exempt from all taxes**, except taxable income from such transactions as may be specified by the Secretary of Finance, upon recommendation of the Monetary Board to be subject to the usual income tax payable by banks: Provided, That interest income from foreign currency loans granted by such depository banks 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 a 10% tax. xxx" (*Emphasis supplied*)

The above exemption, as implemented by Revenue Regulations No. 10-76, includes exemption from documentary stamp tax, gross receipts tax, and branch profit remittance tax. However, with the advent of the 1997 Tax Code, the phrase "exempt from taxes" has been deleted in **Sections 27(D)(3) and 28(A)(7)(b) of the 1997 Tax Code, as amended**, to wit:

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> "SEC. 27. Rates of Income Tax on Domestic Corporations. – xxx
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> (D) Rates of Tax on Certain Passive Incomes. – xxx
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> (3) Tax on 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 (BSP) to transact business with foreign currency depository 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 systems to residents, shall be subject to a final income tax at the rate of ten percent (10%) of such income. xxx"
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> "SEC. 28. Rates of Income Tax on Foreign Corporations. –
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> (A) Tax on Resident Foreign Corporations. – xxx
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> (7) Tax on Certain Incomes Received by a Resident Foreign Corporation. – xxx
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> (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 (BSP) to transact business with foreign currency depository 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 percent (10%) of such income."

By the clear import of the above-quoted provisions, with special emphasis on the deletion of the phrase "exempt from all taxes", the income and transactions of FCDUs are subject to tax. The above laws leave no room for argument or further construction. The amendment by deletion of certain words or phrases in a statute indicates that the legislature intended to change the meaning of the statute.[7]

[7] Gloria vs. Court of Appeals, 306 SCRA 287.

Assuming *arguendo* that such laws require interpretation, still the construction would be in favor of the taxability of FCDUs. As can be seen from the aforequoted provisions, there are no distinctions as to the income or transaction of FCDUs that should be subjected to tax and which are not. It only deleted the tax exemption altogether.

A review of Congressional hearings will prove to be most helpful in ascertaining the rationale behind the subject amendment. The minutes of Senate deliberations on August 11, 1997, in connection with Section 28(A)(7)(b) of the 1997 Tax Code authored by Senator Enrile, the then Chairman of the Senate Ways and Means Committee, show that majority supported the amendment taxing FCDUs and Offshore Banking Units (OBUs). Although there were oppositions, still Congress passed the amendment; indicating the legislative intent to subject FCDUs and OBUs to taxes. Thus, contrary to petitioner's claim, there was no mistake when the 1997 Tax Code removed the tax exemption of FCDUs. In this connection, since the removal of the tax exemption of FCDUs under the 1997 Tax Code was intentional, then RA No. 9294 cannot be given a retroactive effect for the purpose of correcting the alleged mistake.

In fact, the issue of taxability or removal of exemption of FCDU from taxes had been long settled by this Court in the case of **ING Bank (Manila Branch) vs. Commissioner of Internal Revenue.**[8] The pertinent portion of the Decision is quoted hereunder, to wit:

> "The phrase exempt from all taxes has been definitely deleted by the legislators. **The amendment by deletion of certain words or phrases in a statute indicates that the legislature intended to**

[8] CTA Case No. 6017, March 11, 2002.

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> **change the meaning of the statute** (Gloria vs. Court of Appeals, 306 SCRA 287). By virtue of such deletion, Revenue Regulations No. 10-76, which implemented the old law, is no longer applicable. In other words, the payment of the 10% final tax on FCDU income does not exempt Petitioner from the payment of branch profit remittance tax or other taxes for that matter." (*Emphasis supplied*)

Hence, in the absence of any justification for this Court to make a different finding or interpretation regarding the taxability of FCDU income and transactions, then the above opinion remains.

With respect to the second issue, petitioner avers that respondent's assessment for the year 1999 had already prescribed, based on the period specified in Section 203 of the 1997 Tax Code, as amended. The said provision provides that taxes shall be assessed within three (3) years after the last day prescribed by law for filing a return.

Petitioner further claims that Section 222 of the 1997 Tax Code, as amended is not applicable in the instant case because there was no proof of fraud or intent to evade payment of taxes or failure to file returns because no taxes are due.

On the other hand, respondent maintains that the applicable provision of the 1997 Tax Code, as amended is Section 222 rather than Section 203, which provides for a ten (10)-year prescriptive period for assessments. Section 222 deals, among others, with a situation where no returns are filed. In the present case, petitioner failed to file its DST and GRT returns.

Section 222(a) of the 1997 Tax Code, as amended, is quoted hereunder:

> "Section 222. Exceptions as to Period of Limitation of Assessment and Collection of Taxes. – (a) In the case of a false or fraudulent return with intent to evade tax or **of failure to file a return**, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, **at any time within ten (10) years after the discovery of the falsity, fraud or omission**: Provided, That in

> a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof. xxx" (*Emphasis supplied*)

Based on the foregoing, the above provision is applicable not only to situations when there is false or fraudulent return with intent to evade tax, but also when there is failure to file a return. If there is failure to file a return, the prescriptive period for the assessment would be ten years.

In the instant case, **petitioner admitted that it did not file its DST and GRT returns** on the belief that it was not necessary to do so since it was not liable to DST and GRT. However, as can be seen from the law itself, the mere fact of not filing the return would make the ten-year prescriptive period applicable without taking into account the reason for not filing it. Therefore, the assessment of respondent had not yet prescribed.

Finally, with respect to the last issue, petitioner submits that the Formal Letter of Demand/Assessment Notice issued by respondent is arbitrary and without factual basis. In its Petition for Review, petitioner admits that it received an audit notice but denied that there was an actual audit of its FCDU transactions.

Respondent contends that there was no denial of petitioner's due process and that it was sufficiently informed of the factual and legal bases of the assessment, as shown by the fact that petitioner was able to discuss these in its protest to the assessment and in its Petition.[9]

Pertinent in this issue is Section 228 of the 1997 Tax Code, as amended, which is partly quoted below:

[9] Answer, par. 8, Records, page 127.

> "Section 228. Protesting an Assessment. — When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings: Provided, however, That a pre-assessment notice shall not be required in the following cases:
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> **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**." (*Emphasis supplied*)

An assessment contains a computation of the tax liabilities and a demand for payment of such liability within a prescribed period. It is worthy of emphasis that assessment notices need not be a full narration of the facts and laws on which the assessment is based. It is enough that petitioner be **substantially informed** of the law and the facts on which the assessment for a tax liability is made.[10]

We have reviewed the assailed FAN, PAN and Letter of Notice issued by respondent to petitioner as they are found in the BIR records submitted to this Court. It appears that the basis of the deficiency assessment and consequently the issuance of the assailed FAN are the Annual Income Tax returns submitted by petitioner to respondent in connection with petitioner's 10% Final Income Tax. These Annual Income Tax returns are separate and distinct from the DST and GRT returns which petitioner failed to file and caused the application of the 10-year prescriptive period for assessment. It was petitioner itself which supplied the figures, through the said Annual Income Tax returns, that brought about the assessment.

More so, it can be seen that in the PAN's and in the FAN's "Details of Discrepancies", the phrase "verification of the returns" was made, making it clear that an examination was conducted by respondent before the FAN was issued. This

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[10] ATR KIM ENG Financial Corp. vs. CIR, CTA Case No. 5722, May 31, 2004

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shows respondent's compliance with the mandates of the law particularly **Section 56(B) of the 1997 Tax Code**, as amended, quoted as follows:

> "(B) Assessment and Payment of Deficiency Tax. – After the return is filed, **the Commissioner shall examine it and assess the correct amount of the tax**. The tax or deficiency income tax so discovered shall be paid upon notice and demand from the Commissioner. xxx"(*Emphasis supplied*)

Also, as correctly pointed out by respondent, petitioner was able to properly contest the said assessment notices which obviously cannot be done if it was not fully or at least substantially informed of the legal and factual basis of the said assessment.

All of the above show that petitioner was informed of the factual and legal basis of the assessment. Hence, we cannot say that the assessment notice was void for failure to state the assessment's factual basis and that the assessment notice is arbitrary inasmuch as it was based on actual facts gathered from the examination by respondent of petitioner's Income Tax returns. The assessment was not a mere by-product of respondent's imagination.

Well-settled is the rule that tax assessments are entitled to the presumption of correctness and made in good faith. The taxpayer has the duty to prove otherwise. In the absence of proof of any irregularities in the performance of duties, an assessment duly made by a Bureau of Internal Revenue examiner and approved by his superior officers will not be disturbed. All presumptions are in favor of the correctness of tax assessments.[11] Dereliction on the part of petitioner to satisfactorily overcome the presumption of regularity and correctness of the assessment will justify the judicial upholding of said assessment notices.

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[11] Sy Po vs. Court of Tax Appeals, 164 SCRA 524.

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WHEREFORE, the instant Petition for Review is hereby **DENIED DUE COURSE,** and accordingly, **DISMISSED** for lack of merit.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Justice

WE CONCUR:

LOVELL R. BAUTISTA
Associate Justice

CAESAR A. CASANOVA
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

ERNESTO D. ACOSTA
Presiding Justice
Chairman, First Division