REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PHILIPPINE BANK OF
COMMUNICATION,
Petitioner,

- versus - C.T.A. CASE NO. 2725

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

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

1/6/88

D E C I S I O N

This is an appeal from respondent's decision dated June 27, 1975, denying petitioner's protest against the 1971 and 1972 deficiency income tax and the 5% bank tax in the total sum of ₱657,798.44.

The records show that petitioner is a domestic corporation engaged in the banking business with principal office located at 214 Juan Luna, Binondo, Manila (Par. 1, Petition for review, admitted in paragraph i, Answer, pp. 1 and 11, CTA rec.) By virtue of a Letter of Authority No. 33353 NA dated

May 18, 1973 and June 5, 1972, Revenue Examiner Antonio Aguilar of the Financing, Real Estate and Transfer Taxes Audit Division, was authorized by respondent Commissioner of Internal Revenue to examine petitioner's books of accounts and other accounting records covering the year 1972 and all unverified prior years. (Exh. 1, p. 2, Vol. 1, BIR rec.; see also Exh. 13, p. 87, Vol. 1, BIR records.) Examiner Aguilar after his investigation prepared a report dated June 18, 1973 addressed to the respondent Commissioner finding petitioner liable for deficiency income tax in the amounts of ₱277,837.62 and ₱258,791.16 for the years 1971 and 1972, respectively. (Exh. 8, p. 69, Vol. 1, BIR rec.) Likewise, on the same date June 13, 1973, said examiner submitted another report to the respondent Commissioner finding petitioner liable for deficiency 5% bank tax and surcharge in the amounts of ₱54,984.15 and ₱58,408.80 for the same years 1971 and 1972 respectively, and recommended that an assessment be issued to the petitioner to enforce the collection of said deficiency taxes in question. (Exh. 13, p. 87, Vol. 1, BIR rec.)

In view of the aforesaid recommendation of the examiner, respondent Commissioner issued an assessment dated June 25, 1973 (Exh. 14, pp. 93-96, Vol. I, BIR rec.), demanding payment from the petitioner the said deficiency income tax and the 5% bank tax covering the years 1971 and 1972 computed as follows:

Year	Income Tax	Bank Tax	Total
1971	₱282,765.77	₱54,984.15	₱337,749.92
1972	261,639.72	58,408.80	320,048.52
Total	₱544,405.49	₱113,392.95	₱657,798.44

(see also Par. 2, Petition for review, admitted in Paragraph 1, Answer, pp. 1 and 11, CTA rec.)

Petitioner, through its auditor, protested the said assessment in a letter dated August 13, 1973, (Exh. 15, pp. 100-104, Vol. 1, BIR rec.; see Par. 3, Petition, admitted in paragraph 1, Answer pp. 1 and 11, CTA rec.) As to the deficiency income tax, petitioner contends that the disallowance was due to the fact that said amounts represent interest paid to various depositors whose bank deposits were invested in the purchase of government bonds or securities, the income of which is tax-exempt, and the examiners must have relied on a ruling to the effect that bank deposits used to purchase tax-free government bond constitutes loans payable by the banks to its depositors and therefore the interest paid on such deposits is not deductible. Petitioner submits that the interest on bank deposits used to purchase government bonds or securities, the income of which is tax-exempt constitutes allowable deduction. This is because the indebtedness represented by deposits in our bank is not of a kind of indebtedness contemplated under Section 30(b)(1) of the Revenue Code as "indebtedness incurred or continued to purchase and carry obligations." As regards the deficiency bank tax, petitioner contends the sole reason given by the examiners in assessing the 5% bank tax on the interest derived from tax-exempt government bonds is that the exemption applies only to income tax and that this is without legal basis. The certificates of the government bonds purchased by Philippine Bank of Communication for which it derived interest income shows clearly the granting of the tax exemptions and extends to all forms of the exemptions of the Philippine Government.

Petitioner's protest was decided by respondent in his letter dated June 27, 1975, denying petitioner's reconsideration, and reiterated his demand for the payment of the alleged deficiency income tax and bank taxes in the total amount of ₱657,798.44 which letter of denial was allegedly received by petitioner on July 26, 1975. (Exh. 16, pp. 125-127, Vol. I, BIR rec.; see also, paragraph 4, Answer, pp. 2 and 11, CTA rec.)

In view of respondent's letter of denial, petitioner was constrained to interpose its appeal to this Court on August 25, 1975. (p. 1, CTA rec.) On October 11, 1975, respondent filed its answer to said petition and set up the following special and affirmative defenses:

> 4. Deposits in banks, whether commercial or savings bank, in current account or in savings, fixed or time deposits, constitute loans payable by the banks to its depositors and are governed by the provisions concerning simple loans;
>
> 5. Deposits used by petitioner to purchase government bonds constitute an indebtedness of petitioner to its depositors;
>
> 6. The government bonds purchased by petitioner are directly payable to petitioner and not to its depositors;

7. Interest paid by petitioner to its creditors for use of funds invested on tax-free interest-bearing investments payable to petitioner are not deductible interest expenses pursuant to the provisions of Section 30(b)(1)

8. In addition to the 1971 and 1972 deficiency income tax liabilities in question, petitioner is liable to pay 1/2% monthly interest thereon, pursuant to Section 51(d), as amended by Republic Act No. 2343, and 1.16% monthly deficiency interest in accordance with the provisions of Section 51(e)(2) of the Tax Code, as amended by Presidential Decree No. 69;

9. Petitioner is subject to the 5% bank tax provided under Section 249 of the Tax Code;

10. The 5% bank tax is based on gross receipts from any source whatever including those items treated as "gross income", as defined under Section 29 of the Tax Code;

11. Interests earned by petitioner on tax-free interest bearing investments were excluded by the petitioner from its gross receipts in computing the 5% bank tax due for the year 1971 and 1972;

12. The 25% surcharge for late payment is in addition to the deficiency bank tax due from the petitioner pursuant to Section 250 of the Tax Code;

13. The assessments involved herein were issued in accordance with law and regulation on the matter. (see pp. 11-12, CTA rec.)

In the meantime, the Deputy Commissioner of Internal Revenue, on October 17, 1979 issued a memorandum addressed to the Chief, Financing, Real

Estate & Transfer Taxes, requesting the latter that respondent's assessment issued to the petitioner for deficiency income tax and Bank tax be recomputed pursuant to the latest ruling of the BIR addressed to the Banker's Association of the Philippines. (Exh. 17, p. 2, BIR rec., Vol. II.)

After a recomputation of the said deficiency income tax and bank tax by Examiner Antonio Aguilar, he recommended that the original assessment for the deficiency in the amounts of ₱282,765.77 and ₱261,639.72 for the years 1971 and 1972 be set aside, and a modified assessment in the amounts of ₱208,363.67 and ₱222,634.65 be issued for the aforesaid years. (Exh. 22, p. 19, Vol. II, BIR rec.). As regards the bank tax, said Examiner Antonio Aguilar in his memorandum dated February 28, 1980 recommended that the original assessment of ₱54,984.15 and ₱58,408.80 for the years 1971 and 1972 be set aside, and a modified assessment be issued in the amounts of ₱11,518.28 and ₱22,205.23 for the said years 1971 and 1972. (see Exh. 26, p. 31, Vol. II, BIR rec.)

In the meantime, after the termination of the hearing of the instant case in 1983, petitioner on February 17, 1983 filed its consolidated memorandum in CTA Cases Nos. 2979, 3059 and 2725. (see pp. 105-188, CTA rec.) However, on July 17, 1984, a compromise agreement was reach by the parties as regards the settlement of the income tax aspect of this case. (see par. 3, of respondent memorandum filed on April 8, 1986, pp. 229, CTA rec.) Hence, the only issue unresolved and which is now pending before this Court is the 5% bank tax assessment against petitioner. The parties, however, does not question the mathematical computation of the bank tax in question.

The only issue posed before this Court for resolution is whether or not interest income derived by petitioner on Central Bank Certificates of Indebtedness for the years 1971 and 1972 should form part of its gross receipt for the purposes of the 5% bank tax provided for in Section 249 of the Tax Code.

The provision of the law relied upon by respondent in imposing the 5% bank tax is Section 249 (now Section 206) of the Tax Code, which provides as follows:

> Sec. 249. Tax on Banks - There shall be collected a tax of five percentum on gross receipt derived by all banks doing business in the Philippines from interests, discounts, dividends, commissions, profits from exchange, royalties, rentals of property, real and personal, and all other items treated as gross income under Section twenty-nine of this Code.

It should be noted that after a re-investigation by Examiner Antonio L. Aguilar, he submitted a memorandum report dated February 28, 1980 addressed to the Chief, Financing, Real Estate and Transfer Tax Division, recommending the reduction of the 5% bank tax from ₱54,984.15 to ₱11,518.28 for the year 1971, and from ₱58,408.80 to ₱22,205.23 for the year 1972, giving the reason that petitioner's gross receipts from interest income derived by it from certain government bonds are concededly either exempt from taxation or exempt from all taxes. (Exh. 26, par. 3, p. 31, BIR rec., Vol. II) However, those interest income from Central Bank Certificates of Indebtedness (CBCI's) are excludible for purposes of said 5% bank tax. The pertinent portion of the assumption clause of the said Central Bank Certificate of Indebtedness is hereby quoted as follows:

> "Assumption of tax liability. The bank assume payment of the corresponding tax on interest earned and premium, if any,

paid to holder of this certificate" (Exh. D-2, p. 98, BIR rec., Vol. 11, see also pp. 232-233, CTA rec.).

Petitioner contends that inasmuch as the assumption of tax liability clause in the above-quoted Central Bank Certificate of Indebtedness, in not qualifying or limiting the tax assumed to income tax only, such provision should apply literally to include the 5% bank tax in question.

As early as 1971, the Governor of the Central Bank, Gregorio Licaros, had already issued a Central Bank ruling to the effect that only the income tax liability of the holder is covered, and the Bureau of Internal Revenue has understood the Central Bank's assumption of tax liability clause to refer to income tax aspect solely. For ready reference, we hereby quote the said ruling as follows:

November 11, 1971

The Acting President
Bankers Association of
the Philippines
Manila

S i r :

This is in reply to your letter of October 20, 1971 relative to the question raised by Prudential Bank & Trust Company as to whether or not the 5% tax (under Section 249 of the National Internal Revenue Code) corresponding to the interest earned by a bank on its CBCI's is included in the assumption of tax liability on the part of the Central Bank. I wish to advise that the query is answerable in the negative.

In reply of the Director, Securities Market Department of this Bank, to the claim filed by Prudential Bank on May 4, 1971, adequately expressed the background and nature of the abovementioned assumption of tax liability of the Central Bank, and already clarified that only the income tax liability of the holder is covered. The Bureau of Internal Revenue understood the Central Bank"s assumption of liability to refer solely to the income tax and the computation of what the Central Bank remits periodically to the Bureau was based on the best estimate of the income taxes which the holders would have paid on the interest earnings.

A close reading of the pertinent clause in the certificate to the effect that the bank assumes payment of the corresponding tax on interest earned and premium, if any, paid to the holder of this certificate leads to the inescapable conclusion that there is only one type of tax which is assumed by the Central Bank in favor of the holder. This tax can only be the income tax, since holders in general, are not subject to the 5% tax on the gross income of banks under Section 249 of the National Internal Revenue Code.

Please be guided accordingly.

Very truly yours,

(SGD.) G.S. LICAROS
Governor"

(Underlining supplied.)

Sometime on March 11, 1976 the Bureau of Internal Revenue has reiterated the Central Bank ruling to the effect that the Central Bank Certificate of Indebtedness are not among those government bonds and securities enjoying exemption from taxation. The said Bureau of Internal Revenue Ruling is hereby quoted as follows:

March 11, 1976

Bankers Association of the Philippines
Philippine Banking Corporation Building
Bonifacio Drive, M a n i l a

Gentlemen:

I have the honor to inform you that this Office has ruled that, for purposes of computing the 5% bank tax, interests from government bonds or securities, which by specific provision of law, are "exempt from taxation" or "exempt from all taxes" do not form part of the gross receipts on which said tax is imposed, for to include such tax-free interest income as part of the basis of the bank tax would, in effect, nullify the tax exemption specifically provided for in the law.

It should be noted, however, that Central Bank Certificates of Indebtedness (CBCI) are not among those government bonds and securities enjoying exemption from taxation; for although the purchasers thereof are not made to pay income tax on interests earned by them from said certificates, said interests are not actually tax-free, as the Central Bank assumes payment of the income tax due thereon. Such being the case, interests earned by banks from Central Bank Certificates of Indebtedness form part of their gross receipts on which the 5% bank tax shall be computed.

Very truly yours,

(SGD.) EFREN I. PLANA
Acting Commissioner of Internal Revenue
IAN-1456-040-3

(cited under the 2nd par., Exh. 26; Underlining supplied.)

Petitioner relied entirely on the assumption tax liability clause of the Central Bank Certificate of Indebtedness which state that "the bank assumes payment of the corresponding tax on interest earned and premium, if any, paid to the holder of the certificate." It is to be noted that this assumption tax liability clause does not explicitly, equivocally and expressly provide the kind of interest or premium to be included as exempt in the payment of the tax. Nothing is mentioned to the effect that the 5% bank tax in question is included in the exemption, otherwise, it would have so stated in aforesaid assumption tax liability clause as an exemption in the payment of the same. On the contrary, Central Bank as well as the Bureau of Internal Revenue has expressly mentioned in its respective rulings that Central Bank Certificate of Indebtedness are not among those government bonds and securities enjoying exemption from taxation.

A "Certificate of Indebtedness" is defined as a short-term negotiable promissory note issued by a government or corporation as evidence of a floating indebtedness." (p. 266, Third New International Dictionary, 1976 Ed.) A close scrutiny of said certificate of indebtedness (Exh. "D-2", p. 98, Vol. I, BIR rec.) will clearly show that the Central Bank has unilateral obligation to comply with the conditions as provided for in said certificate. It is not, therefore, a bilateral contract as argued by the petitioner and the cited provisions of the instant case. Definitely, the interpretation of said assumption of tax liability clause is within the discretion of the Central Bank since it is the agency of government that issue the bond in question.

To hold the petitioner not liable to the 5% bank tax merely on the basis of its interpretation on the aforesaid clause, which is not expressly and clearly provided for by law is not favored in this jurisdiction. Settled is the rule that tax statutes must be strictly construed against the one claiming the exemption because the law does not look with favor on tax exemptions 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. (Commissioner of Internal

Revenue vs. J.P. Kiener Co., Ltd. G.R. No. L-24754, July 18, 1975, 65 SCRA 142., see also Union Garment, Inc., vs. Court of Tax Appeals, G.R. No. 16809 January 31, 1982, 4 SCRA 304; Commissioner of Internal Revenue vs. Guerero, L-20942, September 22, 1967, 21 SCRA 180, Republic Flour Mills Inc. vs. Commissioner of Internal Revenue, G.R. No. 25602, February 18, 1970, 31 SCRA 520.). Thus, it was held that exemption from taxation are highly disfavored in law; and he who claims an exemption must be able to justify his claim by the clearest grant of organic or statute law. An exemption from the common burden cannot be permitted to exist upon vague implication. (Collector of Internal Revenue vs. Manila Jockey Club, Inc. G.R. No. L-8755, March 23, 1956; 98 Phil. 670; see also House vs. Posadas, 53 Phil., 338 Asiatic Petroleum Co. vs. Llanes, 49 Phil., 466.) In the instant case, there exist no showing that the assumption tax liability clause expressly exempt petitioner from the liability of the 5% bank tax in question.

IN VIEW OF THE FOREGOING, petitioner is hereby ordered to pay the amount of ₱11,518.28 and ₱22,205.23

as deficiency 5% bank tax for years 1971 and 1972, respectively, inclusive of the 25% surcharge as provided in Sections 249 and 250 (now sections 260 and 262) of the Tax Code. With costs against petitioner.

SO ORDERED.

Quezon City, Metro Manila, January 6, 1988.

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