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THIRD DIVISION

[G.R. Nos. 240163 & 240168-69; December 1, 2021]

DEPARTMENT OF FINANCE (DOF), REPRESENTED BY ITS SECRETARY AND THE BUREAU OF INTERNAL REVENUE (BIR) REPRESENTED BY ITS COMMISSIONER, *Petitioners*, *v.* **ASIA UNITED BANK, BDO UNIBANK, INC., BANK OF AMERICA, BANK OF COMMERCE, BDO PRIVATE BANK, INC., CITIBANK, N.A., PHILIPPINES, CHINA BANKING CORPORATION, CHINATRUST (PHILS.) COMMERCIAL BANK CORPORATION, DEUTSCHE BANK AG, MANILA BRANCH, EASTWEST BANKING CORPORATION, ING BANK N.V., MANILA BRANCH, PHILIPPINE BANK OF COMMUNICATIONS, PHILIPPINE NATIONAL BANK, PHILIPPINE VETERANS BANK, PNB SAVINGS BANK, RIZAL COMMERCIAL BANKING CORPORATION, SECURITY BANK CORPORATION, STANDARD CHARTERED BANK, PHILIPPINE BRANCH, UNITED COCONUT PLANTERS BANK, HONGKONG SHANGHAI BANKING CORPORATION LIMITED-PHILIPPINE BRANCHES, HSBC SAVINGS BANK (PHILIPPINES), INC., KOREA EXCHANGE BANK, MANILA BRANCH, JP MORGAN CHASE BANK, N.A., PHILIPPINE BRANCH, UNITED OVERSEAS BANK PHILIPPINES, LAND BANK OF THE PHILIPPINES, DEVELOPMENT BANK OF THE PHILIPPINES, BANK OF THE PHILIPPINE ISLANDS, BPI DIRECT SAVINGS BANK, METROPOLITAN BANK & TRUST COMPANY, UNIONBANK OF THE PHILIPPINES, AND BDO CAPITAL AND INVESTMENT CORPORATION,** *Respondents*.

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D E C I S I O N

ZALAMEDA, *J.*:

While taxes are the lifeblood of the government, the Department of Finance and Bureau of Internal Revenue will do well to bear in mind the boundaries of their power to make administrative issuances. Through this case, We reiterate that the Court will not hesitate to strike down invalid administrative issuances which unduly override the law to be implemented.

The Case

This Petition for Review on *Certiorari* (Petition),[1] raising pure questions of law,[2] seeks to annul and set aside the Order[3] dated 25 May 2018 of Branch 57, Regional Trial Court of Makati City (RTC) in Civil Case Nos. 15-287, 15-291 and 15-411. The assailed Order granted the petition for declaratory relief filed by respondents and declared null and void Revenue Regulations No. (RR) 4-2011 for being issued beyond the authority of the Secretary of Finance (SOF) and Commissioner of Internal Revenue (CIR). Said Order likewise made permanent the Writs of Preliminary Injunction issued on 25 April 2015 and 28 February 2018.

Antecedents

On 15 March 2011, petitioner Department of Finance (DOF), through the SOF, issued RR 4-2011, prescribing the rules on "proper allocation of costs and expenses amongst income earnings of banks and other financial institutions for income tax reporting

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[1] *Rollo*, pp. 35-58.

[2] *See* Section 1, Rule 45 of the Revised Rules of Court:

SECTION 1. *Filing of petition with Supreme Court.— A party desiring to appeal by certiorari* from a judgment or final order or resolution of the Court of Appeals, the Sandiganbayan, the Regional Trial Court or other courts whenever authorized by law, may file with the Supreme Court a verified petition for review on *certiorari*. The petition shall raise only questions of law which must be distinctly set forth. (1a, 2a).

[3] *Rollo*, pp. 67-84; penned by Presiding Judge Honorio E. Guanlao, Jr.

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purposes." The said RR provides that a bank may deduct only those costs and expenses attributable to the operations of its Regular Banking Units (RBU) to arrive at the taxable income of the RBU subject to regular income tax. Any cost or expense related with or incurred for the operations of its Foreign Currency Deposit Units (FCDU)/Expanded Foreign Currency (EFCDU) or Offshore Banking Unit (OBU) are not allowed as deduction from the RBU's taxable income. To compute for the amount allowable as deduction from RBU operations, all costs and expenses should be allocated between the RBU and FCDU/EFCDU or OBU by way of: (1) specific identification, and (2) allocation.[4] Specifically:

March 15, 2011

REVENUE REGULATIONS NO. 4-2011

SUBJECT : **PROPER ALLOCATION OF COSTS AND EXPENSES AMONGST INCOME EARNINGS OF BANKS AND OTHER FINANCIAL INSTITUTIONS FOR INCOME TAX REPORTING PURPOSES**

TO : All Revenue Officials, Employees and Others Concerned

Section 1. Objective -

The purpose of these Revenue Regulations is to clearly set the rules on the allocation of cost and expenses between the Regular Banking Unit (RBU) or Foreign Currency Deposit Unit (FCDU)/Expanded Foreign Currency Deposit Unit (EFCDU) or Offshore Banking Unit (OBU) operations of a depository bank considering that the RBU and FCDU/ EFCDU or OBU is governed by different income taxation regime in the National Internal Revenue Code (NIRC) of 1997 as amended.

These Regulations are likewise applicable to other financial institutions which are subject to or exempt from both regular income and final taxes reference to proper allocation of costs and expenses.

Section 2. General Principles -

Income earnings of banks can be derived from the operations of its RBU or from its FCDU/EFCDU or OBU.

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[4] *Id.* at 68.

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Taxable income derived from operations of RBUs are subject to corporate income tax rate of 30% pursuant to Section 27(A) of the NIRC of 1997, as amended.

Income derived by banks from its FCDUs/EFCDUs or OBUs with respect to foreign currency transactions with non-residents, OBUs in the Philippines, and local commercial banks, including branches of foreign banks authorized to transact business with FCDUs/EFCDUs are exempt from income taxes pursuant to Section 28 of the NIRC of 1997, as amended.

Interest income derived by bank from its FCDU/EFCDU or OBU from foreign currency loans granted to residents other than OBUs and FCDUs/EFCDUs is subject to final tax rate of 10%.

Section 3. Method of Allocation of Cost and Expenses -

Only costs and expenses attributable to the operations of the RBU can be claimed as deduction to arrive at the taxable income of the RBU subject to regular income tax. Any cost or expense related with or incurred for the operations of FCDU/EFCDU or OBU are not allowed as deduction from the RBU's taxable income.

In computing for amount allowable as deduction from RBU operations, all costs and expenses should be allocated between the RBU and FCDU/EFCDU or OBU using the following basis:

1. By Specific Identification

   Expenses which can be specifically identified to a particular unit (RBU, FCDU/EFCDU or OBU) shall be reported and declared as the cost or expenses of that unit.

2. By Allocation

   Common expenses or expenses that cannot be specifically identified for a particular unit shall be allocated based on percentage share of gross income earnings of a unit to the total gross income earnings subject to regular income tax and final tax including those exempt from income tax.

This method of allocation is likewise applicable to other financial institutions with reference to allocating cost and expenses among income earnings derived from active business operation which are subject to regular income tax, passive activities which are subject to final tax and other activities producing income which are exempt from income taxes.

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Section 4. Penalty Clause -

Any person who willfully files a declaration, return or statement containing information which are not true and correct as to every material matter shall, be subject to the penalties prescribed under pertinent law, rules and regulations.

Moreover, any and all applicable criminal offense (e.g., failure to supply correct information) under the NIRC of 1997, as amended, shall be filed against any person who is discovered to have committed any false declaration or misrepresentation.

Section 5. Repealing Clause -

All existing regulations and other issuances or portions thereof which are inconsistent with the provisions of these Regulations are hereby repealed, amended or modified accordingly.

Section 6. Effectivity -

These Revenue Regulations shall take effect immediately.

(Original Signed)
CESAR V. PURISIMA
Secretary of Finance

Recommending Approval:
(Original Signed)
KIM S. JACINTO-HENARES
Commissioner of Internal Revenue[5]

Respondents Asia United Bank, BDO Unibank, Inc., Bank of America, Bank of Commerce, BDO Private Bank, Inc., Citibank, N.A., Philippine Branch, China Banking Corporation, Chinatrust (Phils.) Commercial Bank Corporation, Deutsche Bank AG, Manila Branch, EastWest Banking Corporation, ING Bank N.V., Philippine Bank of Communications, Philippine National Bank, Philippine Veterans Bank, PNB Savings Bank, Rizal Commercial Banking Corporation, Security Bank Corporation, Standard Chartered Bank, Philippine Branch, United Coconut Planters Bank, thus filed a Petition for Declaratory Relief (With Urgent

[5] *Id.* at 85-87.

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Application for the Issuance of a Temporary Restraining Order and/or a Writ of Preliminary Injunction) with the RTC on 06 April 2015,[6] docketed as Sp. Civil Action No. 15-287.

On the other hand, respondent Bank of the Philippine Islands likewise filed a Petition (with Prayer for Issuance of a Temporary Restraining Order and/or Preliminary Injunction) on 01 April 2015, docketed as Civil Case No. 15-291.[7] In the course of the proceedings, the following banks were allowed to intervene: Development Bank of the Philippines, United Overseas Bank Philippines, Land Bank of the Philippines, Metropolitan Bank & Trust Company, UnionBank of the Philippines, and BDO Capital and Investment Corporation.[8]

Essentially, respondents assailed the RR for the following reasons: (1) it was issued without any basis in the Tax Code, thereby encroaching upon the power of the Legislature; (2) it expands the allocation of costs and expenses under Section 50 of the Tax Code, which is limited only to allocating expense deductions between two or more organizations, trades or business; (3) it contravenes Section 43 of the Tax Code that expressly entitles taxpayers to use their chosen accounting method; (4) it unduly limits their rights to claim deductions specifically granted by the Tax Code; (5) it is oppressive and unreasonable as it deprives respondents of their right to claim ordinary and necessary expenses as deductions which effectively amount to deprivation of property without due process of law; (6) the RR was issued without prior consultation with persons affected thereby; and (7) it violates their constitutional right to equal protection since no valid classification exists between respondents, banks and other financial institutions, on the one hand, and other kinds of taxpayers, on the other hand, to justify Bureau of Internal Revenue (BIR)'s requirement upon banks and other financial institutions to adopt the prescribed allocation method under RR 4-2011.[9]

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[6] *Id.* at 354-406.

[7] *Id.* at 160-188.

[8] *Id.* at 67-68.

[9] *Id.* at 356-357, 367-394.

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In its Order dated 27 April 2015, the RTC granted the application for issuance of a writ of preliminary injunction and enjoined petitioners from enforcing, carrying out or implementing in any way or manner the assailed RR against respondents.[10]

For its part, the CIR and DOF assailed the jurisdiction of the RTC over the petition and prayed for the dismissal of the same due to the RTC's lack of jurisdiction over the subject matter.[11]

Ruling of the RTC

On 25 May 2018, the RTC granted the Petition, *viz.*:

> WHEREFORE, in view of the foregoing premises, the Petition for Declaratory Relief in Sp. Civil Action No. 15-287 and the Petition in Civil Case No. 15-291 are GRANTED. Revenue Regulations No. 4-2011 is hereby declared NULL AND VOID for being issued beyond the authority of the Secretary of Finance and Commissioner of Internal Revenue. The Writs of Preliminary Injunction issued on April 25, 2015 and February 28, 2018, respectively, are hereby MADE PERMANENT.
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> **SO ORDERED**.[12]

It ruled that pursuant to Section 1, Rule 63 of the Rules of Court, the RTC has jurisdiction over petitions for declaratory relief. It underlined that based on prevailing jurisprudence, the RTC has jurisdiction over a petition for declaratory relief as to a question of constitutionality of an RR, which was issued by the BIR pursuant to its quasi-legislative power.[13]

The RTC further adjudged that RR 4-2011 is invalid for the following reasons: (1) the imposition of an accounting method on the banks and financial institutions has no basis in Sections 27 (A) and 28, 50, and 43 of the Tax Code; (2) the imposed method of allocation under the RR is not fair nor equitable to a

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[10] *Id.* at 69.

[11] *Id.* at 70.

[12] *Id.* at 84.

[13] *Id.* at 73-76.

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similar class of taxpayers and in contrast to Section 34 (A) (1) (a) of the Tax Code; and (3) the RR failed to meet the criteria for a valid classification under the Equal Protection Clause. The RTC thus held that the RR was issued *ultra vires* for having no basis in the Tax Code or other laws and in violation of the equal protection clause of the Constitution.[14]

Hence, this Petition.

Issues

Aggrieved, the following issues are raised by petitioners for this Court's consideration: (1) whether or not the RTC erred in ruling that it had jurisdiction over the petitions assailing the validity of RR 4-2011; and (2) whether or not RR 4-2011 is a valid regulation issued by the DOF and BIR.[15]

Verily, the main issue of this Court's resolution is whether or not RR 4-2011 is valid. Before passing on this issue, however, this Court must first resolve whether or not the RTC had jurisdiction to hear this case.

Ruling of the Court

The Petition must be dismissed.

Petitioners insist that it is the Court of Tax Appeals (CTA) which has exclusive jurisdiction to determine the constitutionality or validity of tax laws, rules and regulations, and other administrative issuances of the CIR. They also claim that the cases filed before the RTC are not proper for a petition for declaratory relief in view of the previous issuance of Preliminary Notices of Assessment finding deficiency income taxes for taxable year 2011 arising from the failure to allocate costs and expenses pursuant to RR 4-2011. More importantly, petitioners maintain that RR 4-2011 is a valid regulation issued in the exercise of their power to promulgate rules and regulations for the enforcement of the Tax Code. Said RR is issued to set the rules on the allocation of cost and expenses

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[14] *Id.* at 73-84.

[15] *Id.* at 44.

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between the RBU and FCDU/EFCDU or OBU of a depository bank in view of the different income taxation regimes under the Tax Code in order to arrive at a fair and reasonable estimate of the taxable income for a certain income stream. This is achieved by using a percentage of gross income of a specific income earning to the total gross income earnings of the bank which is the process of apportionment prescribed by RR 4-2011.[16]

On the other hand, respondents maintain that RR 4-2011 is an invalid administrative issuance for being issued without legal basis, for curtailing the deductions granted by the Tax Code, and for modifying the Tax Code thereby effectively legislating tax laws.[17]

The findings of this Court shall be discussed *in seriatim*.

A petition for declaratory relief is not the proper remedy to seek the invalidation of RR 4-2011

At the outset, We underline that a petition for *certiorari* or prohibition, not declaratory relief, is the proper remedy to assail the validity or constitutionality of executive issuances.[18]

We recognize, however, our rulings in *Department of Trade and Industry v. Steelasia Manufacturing Corp.*,[19] *Association of International Shipping Lines, Inc. v. Secretary of Finance*,[20] and *Bureau of Internal Revenue v. First E-Bank Tower Condominium Corporation*[21] citing *Department of Transportation v. Philippine Petroleum Sea Transport Association*[22] and *Diaz v. Secretary of*

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[16] *Id.* at 45-51.

[17] *Id.* at 149, 171-172, 254, 333, 377, 496, 536-563, 568.

[18] *Bureau of Internal Revenue v. First E-Bank Tower Condominium Corp.*, G.R. Nos. 215801 & 218924, 15 January 2020 [Per J. Lazaro-Javier].

[19] G.R. No. 238263, 16 November 2020 [Per J. Lazaro-Javier].

[20] G.R. No. 222239, 15 January 2020 [Per J. Lazaro-Javier].

[21] *Supra* at note 18.

[22] G.R. No. 230107, 24 July 2018 [Per J. Velasco].

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Finance,[23] which declared that although a petition for declaratory relief was improper when assailing government issuances, yet, when the issues have "far-reaching implications and raises questions that need to be resolved for the public good; or if the assailed act or acts of executive officials are alleged to have usurped legislative authority," then a petition for declaratory relief may be treated as a petition for *certiorari* or prohibition.[24]

In this case, the validity or invalidity of RR 4-2011 has far-reaching ramifications among banks and other financial institutions in the Philippines. It has been said that the banking industry is impressed with great public interest as it affects economies and plays a significant role in businesses and commerce.[25] Thus, this RR, which affects their method of accounting and the allocation of the costs and expenses to their income earnings, thereby affecting their income tax liability, is imbued with public interest. Furthermore, taxes, being the lifeblood of the government, occupy a high place in the hierarchy of State priorities, hence, all questions pertaining to their validity must be promptly addressed with the least procedural obstruction.[26]

Accordingly, for the Court to decide the case on the merits and lay the issues to rest, We resolve to treat the petition below as a petition for *certiorari* and shall proceed to decide the case on the merits.[27]

The RTC has no jurisdiction over the case

We have held in *Banco de Oro v. Republic*, that the CTA has jurisdiction to rule on the constitutionality or validity of a tax law or regulation or administrative issuance.[28]

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[23] 669 Phil. 371 (2011) [Per J. Abad].

[24] *See Commissioner of Internal Revenue v. Federation of Golf Clubs of the Philippines, Inc.*, G.R. No. 226449, 28 July 2020 [Per J. J.C. Reyes].

[25] *Catapang v. Lipa Bank*, G.R. No. 240645, 27 January 2020 [Per J. Caguioa].

[26] *Supra* at note 18.

[27] *Supra* at note 19.

[28] 793 Phil. 97 (2016) [Per J. Leonen].

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In the 2021 case of *St. Mary's Academy of Caloocan City, Inc. v. Henares*,[29] this Court has reiterated that it is the CTA, and not the RTC, that has the jurisdiction to rule on the constitutionality and validity of revenue issuances by the CIR.[30] This is now the prevailing rule, as affirmed in *COURAGE v. Commissioner of Internal Revenue*.[31]

Thus, the RTC should not have acted upon the petition and should have dismissed the same for lack of jurisdiction. Consequently, the RTC's Order declaring RR 4-2011 as invalid is void.[32]

RR 4-2011 is invalid

Nevertheless, consistent with *Bloomberry Resorts and Hotels, Inc. v. Bureau of Internal Revenue*[33] and *COURAGE v. Commissioner of Internal Revenue*,[34] despite the procedural infirmities of the petition and proceedings before the lower court that warrant the dismissal of the case on technicality and without ruling on the merits, the Court deems it prudent, if not crucial, to take cognizance of, and accordingly act on, the present petition as the validity of the actions of the DOF and CIR that affect numerous banks and other financial institutions is in issue. The Court thus avails itself of its judicial prerogative in order not to delay the disposition of the case at hand and to promote the vital interest of justice.[35]

We rule that RR 4-2011 is void. We now expound.

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[29] G.R. No. 230138, 13 January 2021 [Per J. Leonen].

[30] *Id.*

[31] *Confederation for Unity, Recognition and Advancement of Government Employees v. Commissioner, Bureau of Internal Revenue*, 835 Phil. 297 (2018) [Per J. Caguioa].

[32] *Supra* at note 29.

[33] 792 Phil. 751 (2016) [Per J. Perez].

[34] *Supra* at note 31.

[35] *Id.*

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It is settled that administrative issuances must not override, supplant, or modify the law; they must remain consistent with the law they intend to carry out.[36] When the application of an administrative issuance modifies existing laws or exceeds the intended scope, the issuance becomes void, not only for being *ultra vires*, but also for being unreasonable.[37] Surely, courts will not countenance such administrative issuances that override, instead of remaining consistent and in harmony with the law they seek to apply and implement.[38]

We underline that the power of administrative officials to promulgate rules in the implementation of a statute is necessarily limited to what is provided for in the legislative enactment. The implementing rules and regulations of a law cannot extend the law or expand its coverage, as the power to amend or repeal a statute is vested in the legislature. It bears stressing, however, that administrative bodies are allowed under their power of subordinate legislation to implement the broad policies laid down in a statute by "filling in" the details. All that is required is that the regulation be germane to the objectives and purposes of the law; that the regulation does not contradict but conforms with the standards prescribed by law.[39]

On this note, administrative agencies are not given unfettered power to promulgate rules.[40] As noted in *Gerochi v. Department of Energy*,[41] two requisites must be satisfied in order that rules issued by administrative agencies may be considered valid: the completeness test and the sufficient standard test:

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[36] *Supra* at note 18.

[37] *Executive Secretary v. Southwing Heavy Industries, Inc.*, 518 Phil. 103 (2006) [Per J. Ynares-Santiago].

[38] *Supra* at note 18.

[39] *Public Schools District Supervisors Association v. De Jesus*, 524 Phil. 366 (2006) [Per J. Callejo].

[40] *Quezon City PTCA Federation, Inc. v. Department of Education*, 781 Phil. 399 (2016) [Per J. Leonen].

[41] *Gerochi v. Department of Energy*, 554 Phil. 563 (2007) [Per J. Nachura].

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In the face of the increasing complexity of modern life, delegation of legislative power to various specialized administrative agencies is allowed as an exception to this principle. Given the volume and variety of interactions in today's society, it is doubtful if the legislature can promulgate laws that will deal adequately with and respond promptly to the minutiae of everyday life. Hence, the need to delegate to administrative bodies — the principal agencies tasked to execute laws in their specialized fields — the authority to promulgate rules and regulations to implement a given statute and effectuate its policies. *All that is required for the valid exercise of this power of subordinate legislation is that the regulation be germane to the objects and purposes of the law and that the regulation be not in contradiction to, but in conformity with, the standards prescribed by the law. These requirements are denominated as the* ***completeness test*** *and the* ***sufficient standard test***.[42] (Emphasis supplied)

Further, in *ABAKADA GURO Party List v. Purisima*:

Two tests determine the validity of delegation of legislative power: (1) the completeness test and (2) the sufficient standard test. A law is complete when it sets forth therein the policy to be executed, carried out or implemented by the delegate. It lays down a sufficient standard when it provides adequate guidelines or limitations in the law to map out the boundaries of the delegate's authority and prevent the delegation from running riot. To be sufficient, the standard must specify the limits of the delegate's authority, announce the legislative policy and identify the conditions under which it is to be implemented.[43]

In the absence of appropriate guidelines to this effect, an administrative issuance is invalid.

Indeed, administrative issuances, such as revenue regulations, cannot simply amend the law it seeks to implement. In *Commissioner of Internal Revenue v. Seagate Technology (Philippines)*,[44] We held that a mere administrative issuance, like a

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[42] *Supra* at note 40.

[43] *Id.*, citing *Abakada Guro Party List v. Purisima*, 584 Phil. 246 (2008) [Per J. Corona].

[44] *Commissioner of Internal Revenue v. Seagate Technology (Philippines)*, 491 Phil. 317 (2005) [Per J. Panganiban].

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BIR regulation, cannot amend the law; the former cannot purport to do any more than implement the latter. To reiterate, the courts will not countenance an administrative regulation that overrides the statute it seeks to implement.[45]

Ultimately, this Court once again clarifies that the function of promulgating rules and regulations may be legitimately exercised only for the purpose of carrying out the provisions of the law into effect. Hence, administrative regulations cannot extend the law or amend a legislative enactment, for settled is the rule that administrative regulations must be in harmony with the provisions of the law.[46] It cannot be stressed enough that administrative issuances must not override, but must remain consistent with the law they seek to apply and implement. They are intended to carry out, not to supplant nor to modify, the law.[47] To underscore, it is only the Congress which has the power to repeal or amend the law.[48]

To be sure, RR 4-2011 is anchored on Section 244 of the Tax Code which empowers the SOF, upon recommendation of the CIR, to promulgate rules and regulations for the effective enforcement of the provisions of the Tax Code. As discussed by Associate Justice Japar B. Dimaampao,[49] since RRs are mandated by the Tax Code itself, they are in the nature of a subordinate legislation that is as of the Tax Code it implements.[50] Being products of a delegated power to create new and additional legal provisions

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[45] *Purisima v. Philippine Tobacco Institute, Inc.*, 808 Phil. 697 (2017) [Per J. Carpio].

[46] *See Land Bank of the Phils. v. Court of Appeals*, 319 Phil. 246 (1995) [Per J. Francisco].

[47] *See Commissioner of Internal Revenue v. Court of Appeals*, 310 Phil. 392 (1995) [Per J. Vitug].

[48] *Purisima v. Philippine Tobacco Institute, Inc.*, 808 Phil. 697 (2017) [Per J. Carpio].

[49] *See* Reflections dated 17 November 2021.

[50] *See Clark Investors and Locators Association, Inc. v. Secretary of Finance*, 763 Phil. 79 (2015) [Per J. Villarama, Jr.]; *BPI Leasing Corporation v. Court of Appeals*, 461 Phil. 451 [Per J. Azcuna].

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that have the effect of law, RRs should be within the scope of the statutory authority granted by the legislature to the administrative agency. It is required that the regulation be germane to the objects and purposes of the law, and that *it be not in contravention to, but in conformity with, the standards prescribed by law*.[51]

Here, the BIR expanded or modified the law when it curtailed the income tax deductions of respondents and when it sanctioned the method of accounting the respondents should use, without any basis found in the Tax Code. In fact, in its petition, the DOF and BIR did not even pinpoint the exact provisions of the Tax Code which they seek to apply and implement.

Without a doubt, the RR did not simply provide details for the enforcement of the provisions in the Tax Code. Neither did it interpret the provisions of the Tax Code. Instead, RR 4-2011 modified what was explicitly provided therein. This amounts to tax legislation which is a matter within the authority of the legislative department only.

First, **RR 4-2011 contravenes Section 43,**[52] **of the Tax Code**. This provision provides the general rule for taxpayer's accounting periods and methods of accounting.[53] It unequivocally states that taxpayers are allowed to self-determine the most applicable accounting method. The CIR may only prescribe an accounting method if any of the following conditions exist: (a) no accounting

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[51] *See Commissioner of Customs v. Hypermix Feeds Corporation*, 680 Phil. 681 (2012) [Per J. Sereno].

[52] **Section 43. *General Rule***. – The taxable income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) **in accordance with the method of accounting regularly employed in keeping the books of such taxpayer**, but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner clearly reflects the income. If the taxpayer's annual accounting period is other than a fiscal year, as defined in Section 22(Q), or if the taxpayer has no annual accounting period, or does not keep books, or if the taxpayer is an individual, the taxable income shall be computed on the basis of the calendar year. (Emphasis supplied)

[53] *Supra* at note 47.

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method has been employed by the taxpayer; or (b) while an accounting method has been employed, it does not clearly reflect the income of the taxpayer. Accounting methods for tax purposes "comprise a set of rules for determining when and how to report income and deductions."[54]

In the case of *Commissioner of Internal Revenue v. Lancaster Philippines, Inc.*,[55] the Court ingeminated that an accounting method is a set of rules for determining when and how to report income and deductions.[56] Chapter VIII, Title II of the Tax Code enumerates the following recognized methods of accounting:

(1) Cash basis method;[57]
(2) Accrual method;[58]
(3) Installment method;[59]
(4) Percentage of completion method;[60] and
(5) Other accounting methods.

Any of the foregoing methods may be employed by any taxpayer so long as it reflects its income and expenses properly. The peculiarities of the business or occupation engaged in by a taxpayer would largely determine how it would report income and expenses in its accounting books or records. The Tax Code does not prescribe a uniform, or even a specific method of accounting. Nevertheless, other methods approved by the CIR, even when not expressly mentioned in the Tax Code, may be adopted if such method would enable the taxpayer to properly reflect its income.[61]

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[54] *Commissioner of Internal Revenue v. Isabela Cultural Corp.*, 544 Phil. 488 (2007) [Per J. Ynares-Santiago].

[55] 813 Phil. 622 (2017) [Per J. Martires].

[56] *See Consolidated Mines, Inc. v. CTA*, 157 Phil. 608 (1974) [Per CJ Makalintal].

[57] TAX CODE, Sec. 45.

[58] *Id.*

[59] TAX CODE, Sec. 49.

[60] TAX CODE, Sec. 48.

[61] *Supra* at note 55.

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In this case, the conditions under Section 43 of the Tax Code are not present. There is no showing that banks and financial institutions have not employed an accounting method, or that the accounting method employed do not reflect said banks and financial institutions' true income. Clearly, therefore, the allocation rules under RR 4-2011 are arbitrary and indiscriminate imposition of a uniform accounting method as it dictate the amount that banks may reflect as deductions and taxable income. We thus agree with respondents that by imposing the allocation method under the RR, petitioners negated respondents' right to adopt its own accounting method.

Without any finding that the accounting method employed by said taxpayers do not reflect their actual income, there is no basis for petitioners to impose an accounting method for allocating the expenses of respondents. The CIR cannot simply substitute its own judgment and impose an accounting method on the taxpayer without any reasonable ground, in contravention of the taxpayer's right to use any accounting method of its choice. To be sure, the CIR may only challenge the propriety of the accounting method employed after the taxpayer has filed a tax return through an audit investigation or assessment of a particular taxpayer when the CIR can properly make a finding on the existence of a distortion, that is, on whether the accounting method used did not clearly reflect income.

Second, **RR 4-2011 unduly expands Section 50**[62] **of the Tax Code**. Under the said provision, the CIR is authorized to distribute, apportion, or allocate gross income or deductions if they determine that such distribution, apportionment, or allocation: (a) is necessary in order to prevent evasion of taxes; or (b) clearly to reflect the income of organizations, trades, or businesses.

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[62] **Section 50.** ***Allocation of Income and Deductions***. – In the case of two or more organizations, trades or businesses (whether or not incorporated and whether or not organized in the Philippines) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion or allocate gross income or deductions between or among such organization, trade or business, if he determines that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations, trades or businesses.

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Applying the foregoing, We find that these conditions are not met or supported by evidence in this case. The records are bereft of any indication that the allocation under RR 4-2011 is necessary to prevent evasion of taxes, or to reflect their true income. Thus, the exercise of CIR's authority under Section 50, through the issuance of RR 4-2011, is misplaced.

It also bears emphasis that Section 50 is limited only to allocating expense deductions between two or more organizations, trades or business. In *Filinvest Development Corp. v. CIR*, the Supreme Court explained that the purpose of Section 50 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer by determining, according to the standard of an uncontrolled taxpayer, the true net income from the property and business of a controlled taxpayer. If this has not been done and the taxable net incomes are understated, the law grants the CIR the authority to intervene by making distributions, apportionments or allocations of gross income or deductions among the controlled taxpayers to determine the true net income of each controlled taxpayer.[63]

To further elucidate, We quote the explanation of Associate Justice Dimaampao in his Reflections dated 17 November 2021:

> Controlled taxpayers—those engaged in more than one organization, trade or business owned or controlled by the same interests—may opt to use a different method of accounting for each organization, trade or business. It may utilize cash method for reporting income and expenses in one operation and the accrual method with respect to the other. While the taxpayer may not ordinarily combine the cash and accrual methods, the use of a *hybrid method of accounting*—combining the cash and accrual methods—may be recognized under circumstances and requirements set out in regulations. Correspondingly, where it is satisfactorily shown that the taxpayer's accounting method and procedure as reflected in the statement of income or loss is adequate, its use will be recognized.[64]

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[63] Eric R. Recalde, A Treatise on Philippine Internal Revenue Taxes (2014), p. 372 *citing Filinvest Development Corp. v. CIR*, 669 Phil. 323 (2011), 19 July 2011 [Per J. Perez].

[64] *See Fernandez Hermanos, Inc. v. Commissioner of Internal Revenue*, 140 Phil. 31 (1969) [Per J. Teehankee].

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In determining the true net income of a controlled taxpayer in transactions with another controlled taxpayer, the CIR is not restricted to the cases of improper accounting, fraudulent transactions, or distortion or shifting of income and deductions to reduce or avoid tax. Its power extends to cases where, inadvertently or by design, the net income is other than what it would have been had it been an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer. In other words, Section 50 of the Tax Code places a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true net income from the property and business of a controlled taxpayer.[65]

Various issuances of the BIR itself illustrate the import of Section 50 of the Tax Code. In Revenue Audit Memorandum Order 1-1998,[66] the BIR recognizes that "the authority for allocating income and expenses between or among related parties" under Section 50 pertains to the "allocation of income and expenses between or among controlled group of companies, if related taxpayer has not reported its true taxable income."[67] Moreover, it confirms that Section 50 is intended to place "a controlled taxpayer in tax parity with an uncontrolled taxpayer by determining the arm's-length price of intercompany transactions."[68]

RR 2-2013, which provides the guidelines for the method of income/cost allocation in related party transactions (*i.e.*, transfer pricing), explicitly invokes Section 50 of the Tax Code, which authorizes the CIR "to distribute, apportion or allocate gross income or deductions between or among two or more organizations, trades or businesses (whether or not incorporated and whether or not organized in the Philippines) owned or controlled directly or indirectly by the same interests, if he determines that such

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[65] Commonwealth Act No. 466, Sec. 179(b) of Revenue Regulations No. 2.

[66] *Id.* citing Revenue Audit Memorandum Order No. 1-98, as amended by Revenue Memorandum Order No. (RMO) 61-98, as further amended by RMO 63-99. These issuances provide for the audit guidelines and procedures in the examination of interrelated group of companies.

[67] RMO 1-98, par. 2.3.1.

[68] RMO 1-98, par. 2.3.2.

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distribution, apportionment or allocation is necessary in order to clearly reflect the income of such organization, trade or business. Thus, the Commissioner is authorized to make transfer pricing adjustments[.]"

It was explained therein that transfer pricing is generally defined as the pricing of intra-firm transactions between related parties or associated enterprises.[69] Parties are considered related if they are owned or controlled, directly or indirectly, by the same interests. There is a domestic transfer pricing issue when income are shifted in favor of a related party with special tax privileges, or when expenses of a related company subject to regular income taxes or in other circumstances, when income and/or expenses are shifted to a related party in order to minimize tax liabilities. The revenues lost from intra-related transactions can be attributed to the fact that related companies are more interested in their net income as a whole (rather than an individual corporation), as such there is a desire to minimize tax payments by taking advantage of the loopholes in the tax system.

Verily, there is a need to determine the arm's length price only when one organization, trade, or business passes off a cost to a related organization, trade, or business at an amount different from what would have been charged had the transaction been between two unrelated organizations, thereby manipulating the amount of the reported income of the organizations. For this purpose, Section 50 grants authority to the CIR to allocate expense deduction where transactions involving more than one organization, trade, or business are not done at arm's length.[70]

In this case, RR 4-2011 provides for an allocation method for different units or income streams within **one bank or financial institution**. Under the Bangko Sentral ng Pilipinas (BSP) rules. FCDU/EFCDU refers to a unit of a local bank or of a local branch of a foreign bank authorized by the BSP to engage in foreign currency-denominated transactions, pursuant to the provisions

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[69] RR No. 2-2013, Background.

[70] *Rollo*, p. 424.

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of Republic Act No. 6426 (RA 6426 or Foreign Currency Deposit Act of the Philippines),[71] while RBU pertains to the unit that handles all transactions other than those which banks engage in pursuant to their respective FCDU/EFCDU licenses.[72] To reiterate, these two (2) units are part of a single bank or financial institution. It is hence evident that Section 50 cannot be invoked as statutory basis for RR 4-2011 to require the allocation of costs and expenses among different units or income streams within a bank or single business unit thereof.

The CIR, through RR No. 4-2011, allocates costs and expenses between operations of a depository bank and other financial institutions.[73] Essentially, only those costs and expenses attributable to the operations of the RBU can be claimed as deduction to arrive at the taxable income of the RBU subject to income tax; those related or incurred for the operations of FCDU/EFCDU or OBU are not allowed as deductions from the RBU's taxable income. In computing for amount allowable as deductions from RBU operations, all costs and expenses should be allocated between the RBU and FCDU/EFCDU or OBU using specific identification or by allocation. The CIR ratiocinates that the differences in the income taxation regime of the RBU, FCDU/EFCDU, and OBU warrant the allocation of costs and expenses.[74]

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[71] BSP Manual of Regulations on Foreign Exchange Transactions (updated as of September 2021), Sec. 70.

[72] BSP Banking Laws of the Philippines, Book III, Special Banking Laws Annotated (2012), p. 567.

[73] RR 4-2011, Sec. 1.

[74] The taxable income derived from RBUs are subject to corporate income tax rate pursuant to Section 27 (A) of the Tax Code. Meanwhile, income derived by banks from its FCDUs/EFCDUs or OBUs with respect to foreign currency transactions with non-residents, OBUs in the Philippines, and local commercial banks, including branches of foreign banks authorized to transact business with FCDUs/EFCDUs are exempt from income tax pursuant to Section 28 of the Tax Code. On the other hand, interest income derived by banks from its FCDU/EFCDU or OBU from foreign currency loans granted to residents other than OBUs and FCDUs/EFCDUs is subject to final tax rate pursuant to Section 28 of the Tax Code.

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By prescribing a method for allocating and reporting expenses, the CIR effectively derogated the right of taxpayer banks and other financial institutions to adopt its own accounting method. Moreover, a difference in tax treatment of income flowing to a single taxpayer—as in the case of respondents—does not automatically merit a taxpayer's classification as controlled taxpayer to warrant the allocation of income and deductions. To reiterate, Section 50 of the Tax Code authorizes such allocation if the CIR *determines that such allocation is necessary in order to prevent evasion of taxes or clearly reflect the income of any such organization, trade, or business*. There is no showing that RR 4-2011 was issued to prevent evasion of taxes nor to clearly reflect the income of controlled taxpayer's organization, trade, or business.[75]

Third, following the CIR's arbitrary imposition of allocation rules, **RR 4-2011 inevitably impairs the taxpayers' right to claim deductions under Section 34 of the Tax Code**. In issuing said RR, which requires the aforesaid allocation of costs and expenses of banks with respect to its RBU and FCDU/EFCDU or OBU operations and as to its "tax paid income" and "tax exempt income" activities, petitioners effectively imposed an additional requirement for deductibility of expenses which is not provided under the Tax Code. RR 4-2011, therefore, effectively qualified the deduction bestowed by the Tax Code, thereby modifying the law.

Under Section 34 (A) (1) of the Tax Code, the taxpayer has the right to claim as deductions from its gross income all the ordinary and necessary expenses paid or incurred in carrying on, or which are directly attributable to the development, management, operation and/or conduct of its trade or business, to arrive at the correct amount of taxable income.

We agree with respondents that common expenses should be deductible in full against its income subject to regular tax. As currently worded, all expenses are deducted directly and in full without any allocation or attribution between the different income streams. There is no requirement to allocate the common expenses

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[75] *Supra* at note 47.

to its income subject to Final Withholding Tax or exempt income. There is no distinction for common expenses among income streams, as these are, after all, common expenses. Thus, there can be no allocation of expenses between different income in the same trade or business unit.[76]

We are aware of the matching principle of accounting, which provides that expenses should be matched to their corresponding revenues. However, said principle should be applied *vis-a-vis* the CIR's authority to interpret the Tax Code. RR 4-2011 requires that "common expenses or expenses that cannot be specifically identified for a particular unit shall be allocated based on percentage share of gross income earnings of a unit to the total gross income earnings subject to regular income tax and final tax including those exempt from income tax." The amount that will be allocated to RBU and FCDU/EFCDU or OBU are mere estimates based on a ratio which finds no statutory basis under the Tax Code. As discussed, this is beyond the contemplation of Section 50.

Verily, the permissible deductions under Section 34 (A)(1) of the Tax Code were effectively modified, limited and qualified by RR 4-2011 since the same are being deducted or allocated to tax exempt or final tax paid income, in violation of the law and prevailing jurisprudence. To be sure, revenue regulations cannot unduly curtail, and essentially amend, the tax reliefs unequivocally provided by the Tax Code to taxpayers.

Moreover, it bears noting that prior to the passage of RA 6426, one of the main economic challenges of the country was its unstable financial condition which was greatly caused by, among other factors, heavy dollar spending. This, in turn, caused a dollar deficit in our country. Dollars were necessary to finance foreign currency liabilities and dollar-denominated transactions. Foreign currencies were also considered to be part of the country's internal reserves. To address this deficit and increase reserves, the government encouraged foreign currency deposits in duly authorized banks in order that these may be put into the stream of the banking system. Towards this end, RA 6426 provided tax

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[76] *Supra* at note 47 at 144-146, 168-170, 331-334, 383-384, 389.

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exemptions and incentives to FCDU deposits, as well as banks and financial institutions having FCDU license.[77] Thus, to give life and meaning to the intention of legislature in the enactment of RA 6426, We agree that common expenses should be deducted from RBU income, instead of allocating a portion to be deducted from FCDU/EFCDU or OBU income.

Given the foregoing, there is no need for this Court to discuss the constitutional aspect of due process clause as RR 4-2011 itself clearly demonstrates how it has unduly expanded the provisions of the Tax Code, making its issuance an *ultra vires* act on the part of the SOF.

Nevertheless, to complete Our analysis of RR 4-2011, We find that it was issued in violation of due process requirements. Considering the burden imposed by RR 4-2011, the requirements of notice, hearing, and publication should have been strictly observed.[78] Indeed, when the administrative rule goes beyond merely providing for the means that can facilitate or render least cumbersome the implementation of the law but substantially increases the burden of those governed, as in this case, it behooves the agency to accord at least to those directly affected a chance to be heard, and thereafter to be duly informed, before that new issuance is given the force and effect of law.[79]

In the present case, RR 4-2011 increases the burden upon the banks and other financial institutions and imposes a penalty in case of its violation. As discussed, prescribing a particular method for allocation of costs and expenses will necessarily result in the limitation or reduction of the amount of deductible expenses allowed to banks and other financial institutions. Moreover,

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[77] BSP Banking Laws of the Philippines, Book III, Special Banking Laws Annotated (2012), p. 559.

[78] *Manila Public School Teachers' Association v. Garcia*, 819 Phil. 53 (2017) [Per J. Sereno].

[79] *See DENR Employees Union v. Abad*, G.R. No. 204152, 19 January 2021 [Per CJ Peralta]; *Commissioner of Customs v. Hypermix Feeds Corp.*, 680 Phil. 681 (2012) [Per J. Sereno]; *See also Commissioner of Internal Revenue v. Court of Appeals*, 329 Phil. 987 (1996) [Per J. Vitug].

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violation thereof results to the imposition of a penalty. This substantially adds to the burden of the subject taxpayers. The due observance of the requirements of notice, of hearing, and of publication, then, should not have been ignored by petitioners.[80]

Moreover, violation thereof results in the imposition of a penalty. This substantially adds to the burden of the subject taxpayers. The due observance of the requirements of notice, hearing and publication, then should not have been ignored by petitioners.[81]

For failing to conduct prior notice and hearing before coming up with RR 4-2011,[82] said RR should also be declared defective and ineffectual.[83]

In fine, the CIR is empowered to interpret our tax laws but not expand or alter them. In the case of RR 4-2011, however, the CIR went beyond, if not, gravely abused such authority.[84] Consequently, given the above substantive and procedural irregularities in its issuance, RR 4-2011 is null and void.[85]

WHEREFORE, premises considered, the petition is **DENIED** and the Revenue Regulations No. 4-2011 issued by the Secretary of the Department of Finance is declared **VOID** for having been issued *ultra vires*.

SO ORDERED.

Leonen (Chairperson), *Carandang, Rosario,* and *Marquez, JJ.*, concur.

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[80] *Commissioner of Internal Revenue v. Court of Appeals*, *id.*

[81] *Id.*

[82] *Rollo*, pp. 52, 151, 336-337, 391-393.

[83] *See GMA Network, Inc. v. Commission on Elections*, 742 Phil. 174 (2014) [Per J. Peralta].

[84] *See Bureau of Internal Revenue v. First E-Bank Tower Condominium Corp.*, *supra* at note 18.

[85] *See Purisima v. Philippine Tobacco Institute, Inc.*, *supra* at note 43.

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