

ADVISORY ON DECLARATION OF NULLITY OF RULES ON COST ALLOCATION FOR BANKS AND OTHER FINANCIAL INSTITUTIONS

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SUPREME COURT CASE 2
DEPARTMENT OF FINANCE vs. ASIA UNITED BANK
G.R. NO. 240163 and 240168-69

Supreme Court decision declaring Revenue Regulations (RR) No. 4-2011, which prescribes the rules on cost allocation for banks and other financial institutions, as void for having been issued *ultra vires*

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SUPREME COURT CASE

DEPARTMENT OF FINANCE vs. ASIA UNITED BANK

G.R. NO. 240163 and 240168-69

Revenue Regulations (RR) No. 4-2011 issued by the Secretary of the Department of Finance is declared void for having been issued *ultra vires*

BACKGROUND

The Department of Finance ("DOF") issued Revenue Regulations ("RR") No. 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 purposes.

The RR provides that:

- only costs and expenses attributable to the operations of the Regular Banking Units ("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 Foreign Currency Deposit Units ("FCDU")/Expanded Foreign Currency Deposit Units ("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.

RR NO. 4-2011 ON PROPER ALLOCATION OF COSTS AND EXPENSES IS INVALID

The Supreme Court ("SC") declared the invalidity of RR No. 4-2011 since it modified what was explicitly provided in the Tax Code. Specifically, the SC noted the following:

**RR 4-2011
contravenes
Section 43 of the
Tax Code**

The Commissioner of Internal Revenue ("CIR") may only prescribe an accounting method if any of the following conditions exist:

- (a) no accounting 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.

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 allocation rules under RR No. 4-2011 are arbitrary and indiscriminate imposition of a uniform accounting method as it dictates the amount that banks may reflect as deductions and taxable income.

RR 4-2011 unduly expands Section 50 of the Tax Code

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.

Section 50 is limited only to allocating expense deductions between two or more organizations, trades or business. However, RR No. 4-2011 provides for an allocation method for different units or income streams within one bank or financial institution. **RBU and FCDU/EFCDU are part of a single bank or financial institution.**

RR 4-2011 inevitably impairs the taxpayers' right to claim deductions under Section 34 of the Tax Code

The DOF and Bureau of Internal Revenue effectively imposed an additional requirement for deductibility of expenses which is not provided under the Tax Code.

There is no requirement to allocate the common expenses 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.**

Administrative issuances must not override, supplant, or modify the law; they must remain consistent with the law they intend to carry out. 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.

It should be noted, however, that although RR No. 4-2011 was declared void, the Supreme Court ruled that a declaratory relief filed before the Regional Trial Court is not the proper remedy to assail the validity or constitutionality of executive issuances. Instead, the taxpayers should have filed a petition for certiorari or prohibition before the Court of Tax Appeals.

Source:

[Department of Finance v. Asia United Bank, G.R. Nos. 240163 & 240168-69, December 1, 2021](#)