

Facts:

On March 15, 2011, the Department of Finance (DOF), through the Secretary of Finance (SOF), issued Revenue Regulations No. (RR) 4-2011. This regulation prescribed rules for the proper allocation of costs and expenses among income earnings of banks and other financial institutions for income tax reporting purposes. The regulation mandated that only costs and expenses attributable to the Regular Banking Units (RBU) operations could be deducted to calculate the taxable income for RBUs. Costs and expenses related to Foreign Currency Deposit Units (FCDU)/Expanded Foreign Currency (EFCDU) or Offshore Banking Unit (OBU) operations could not be deducted from the taxable income of the RBU.

Respondents, including Asia United Bank and other financial institutions, filed Petitions for Declaratory Relief with the Regional Trial Court (RTC) of Makati, City, challenging the validity of RR 4-2011 on April 1 and April 6, 2015. They argued that the regulation was without basis in the Tax Code, unduly extended the limits of cost and expense allocation under Section 50 of the Tax Code, contravened Section 43 allowing taxpayers to choose their accounting methods, restricted rights to claim deductions, was oppressive, lacked prior consultation, and violated equal protection rights.

On April 27, 2015, the RTC issued an order granting a writ of preliminary injunction against the enforcement of RR 4-2011. On May 25, 2018, the RTC granted the petitions, declaring RR 4-2011 null and void for being issued beyond the authority of the SOF and CIR. The DOF and BIR then filed a Petition for Review on Certiorari before the Supreme Court, questioning the RTC's jurisdiction and the validity of RR 4-2011.

Issues:

1. Does the RTC have jurisdiction to entertain petitions for declaratory relief regarding the validity of RR 4-2011?
2. Is RR 4-2011, issued by the DOF and BIR, a valid exercise of their quasi-legislative powers?

Court's Decision:

The Supreme Court dismissed the petition filed by the DOF and BIR.

1. Jurisdiction of the RTC:

The Court upheld that the proper venue to challenge the validity of tax regulations was the Court of Tax Appeals (CTA) and not the RTC. The CTA has exclusive jurisdiction to determine the validity of tax laws, rules, and regulations. However, since the issues raised had far-reaching public implications, the Supreme Court treated the RTC petition as one for certiorari, discussing the merits of the case to expedite resolution.

## 2. Validity of RR 4-2011:

The Supreme Court declared that RR 4-2011 was invalid. Administrative regulations must not override, supplant, or modify the law. RR 4-2011 improperly curtailed income tax deductions allowed under the Tax Code without any legislative basis. It unduly mandated a specific allocation accounting method, violating Section 43 which grants taxpayers the right to choose their accounting methods unless their method does not clearly reflect income. It also improperly expanded Section 50 and introduced arbitrary allocation of expenses not warranted by the Tax Code, thus altering the statutory provisions. The Court emphasized that only Congress can amend the law, not administrative agencies. The regulation also failed to comply with due process requirements as it increased the taxpayer's burden without notice, hearing, or consultation.

## Doctrine:

1. Administrative issuances must not modify or override laws and must be consistent with the legislation they implement.
2. A taxpayer's entitlement to choose their accounting method cannot be curtailed without a statutory basis.
3. The authority to allocate expenses under Section 50 of the Tax Code is limited and cannot be expanded without legislative authorization.
4. Issuance of administrative regulations requires adherence to due process especially when they impose significant burdens.

## Class Notes:

1. **\*\*Administrative Law Principle\*\***: Administrative regulations must conform to the enabling legislation and cannot extend or amend statutory provisions.
2. **\*\*Accounting Methods\*\***: Taxpayers are entitled under Section 43 of the Tax Code to choose their own accounting methods unless explicitly mandated otherwise by legislature.
3. **\*\*Expense Allocation\*\***: Section 50 of the Tax Code permits the allocation of expenses only under specific conditions to prevent tax evasion or accurately reflect income.

4. **\*\*Equal Protection and Due Process\*\***: Changes in tax regulations that increase burdens on taxpayers must provide notice and opportunity for affected parties to be heard. <sup>Digest)</sup>

Historical Background:

The dispute arose amid efforts by the DOF and BIR to regulate the allocation of costs and expenses of financial institutions in response to varying income taxation regimes under Philippine law. The overarching legal conflict focused on ensuring that such regulatory efforts adhered to legislative intent and did not overstep the boundaries of administrative powers. This case is a reminder of the delicate balance between regulatory enforcement and legislative prerogatives. The Court's decision reinforced the doctrine that administrative bodies cannot expand or modify statutory provisions through regulations, underscoring the constitutional principles of legislative power and due process.