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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PHILIPPINE FUND, INCORPORATED,
Petitioner,

- versus - C.T.A. CASE NO. 4461

5/13/94

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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DECISION

This is claim for a tax refund or issuance of a tax credit certificate in the amount of P2,264,839.27 representing the alleged overpaid final tax withheld on interest income for the period from May 1988 to May 1989.

Petitioner, a non-resident corporation, purchased Central Bank Special Series Bills (CBSSB's) with a total face value of P2,542,900,000.00 during the period from May 31, 1988 to May 2, 1989.

The Central Bank of the Philippines deducted and withheld from the total interest of P45,296,785.10 the 20% final withholding tax amounting to P9,059,357.03, computed as follows:

Date Purchased	Face Amount	Interest	20% W/T
31 May '88	P301,800,000.00	P10,199,457.96 (13.991)	P2,039,891.59
29 Aug. '88	310,300,000.00	10,578,769.08 (13.963)	2,115,753.82
28 Nov. '88	313,600,000.00	4,094,262.26 (15.362)	818,852.45
29 Dec. '88	317,200,000.00	4,509,141.16 (16.223)	901,828.23
30 Jan. '89	320,200,000.00	3,753,581.93 (14.234)	750,716.39
1 Mar. '89	323,300,000.00	3,866,476.61 (14.525)	773,295.32
31 Mar '89	326,600,000.00	4,183,108.40 (14.596)	836,621.68
2 May '89	329,900,000.00	4,111,987.70 (15.146)	822,397.54
			P9,059,357.02

Alleging that the corporation is not subject to 20% but only to 15% final tax, petitioner is now claiming that it should be held liable only for the amount of P6,794,517.76, as computed hereunder:

Date Purchased	Face Amount	Interest	15% W/T
31 May '88	P301,800,000.00	P10,199,437.96 (13.991)	P1,529,918.69
29 Aug. '88	310,300,000.00	10,578,769.08 (13.963)	1,586,815.36
28 Nov. '88	313,600,000.00	4,094,262.26 (15.362)	614,139.34
29 Dec. '88	317,200,000.00	4,509,141.18 (16.223)	676,371.17
30 Jan. '89	320,200,000.00	3,753,581.98 (14.234)	563.037.29
1 Mar. '89	323,300,000.00	3,866,476.61 (14.525)	579,971.49
31 Mar. '89	326,600,000.00	4,183,108.40 (14.596)	627,466.26
2 May '89	329,900,000.00	4,111,987.70 (15.146)	616,798.16
			P6,794,517.76

On August 4, 1989, petitioner filed its request for tax refund or tax credit of the amount of P2,264,839.27 corresponding to the difference between 20% and 15% final tax on interest income as shown in the computation below:

20% Tax	....	P9,059,357.02
15% Tax	.... -	P6,794,517.76
Overpayment	....	P2,264,839.26

The respondent Commissioner of Internal Revenue failed to act on petitioner's request prompting the latter to file the instant petition for review.

The sole issue for this Court's determination is whether or not petitioner is entitled to a tax refund or credit in the amount of P2,264,839.27 representing alleged overpaid final tax withheld on interest income.

Article 12(2) of the RP-US Tax Treaty provides:

> "Interest derived by a resident of one of the Contracting States from sources within the other Contracting State shall not be taxed by the other contracting state at a rate in excess of 15% of the gross amount of such interest."

Respondent's denial of the claim for refund or tax credit is based on her position that petitioner maintained a permanent establishment in the Philippines.

Pertinent provisions of paragraph 5 of Article 12 of the same Tax Treaty read as follows:

> "Paragraphs (2) (3) and (4) shall not apply if the recipient of interest from sources within one of the Contracting States, being a resident of the other Contracting State carries

on business in the first mentioned Contracting States, through a permanent establishment situated therein or performs in that other State independent personal services from a fixed base situated therein and the debt claim in respect of which the interest is paid is effectively connected with such permanent establishment of fixed base. In such a case, the provision of Article 8 (Business Profits) or Article 15 (Independent Personal Services) as the case may be, shall apply."

Paragraphs 4(a) and 5 of Article 5 of RP-US Tax Treaty, on the concept of "permanent establishment", provides:

"4. A person acting in one of the Contracting States on behalf of a resident of the other Contracting State, other than an agent of an independent status to whom paragraph (5) applies, shall be deemed to give rise to a permanent establishment in the first-mentioned Contracting State if -

(a) Such person has, and habitually exercised in the first-mentioned Contracting State, an authority to conclude contracts in the name of that resident, unless the exercise of such authority is limited to the purchase of goods and merchandise for that resident." (underscoring supplied)

5. A resident of one of the Contracting States shall not be deemed to have a permanent establishment in the other Contracting State merely because such resident carries on business in that other Contracting State through a broker, general commission agent, or any other agent of an independent status, where such broker or agent is acting in the ordinary course of his business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that resident, he shall not be considered an agent of independent status within the meaning of this paragraph, if the transactions between the agent and the

resident were not made under arm's length condition. (Underscoring for emphasis)

xxx xxx xxx"

In her Memorandum (C.T.A. Records, pp. 131-132), respondent thus explained:

"It is likewise worthy to note, as earlier stated, that petitioner is 100% indirectly owned by Security Pacific National Bank wherein Guia S. Hernandez, the Attorney-in Fact of herein petitioner, is an employee and is holding office for the petitioner in connection with the aforestated sole business activity in the Philippines.

Moreover, it is a basic consideration in the application of tax treaties, in the instant case, RP-US Tax Treaty, that the recipient of the income (interest income) derived from the Contracting State, <u>be a resident of the other Contracting State</u>. In the instant case, no interest income derived by petitioner from its Central Bank Special Series Bills holdings in the Philippines was ever remitted to petitioner in Delaware, U.S.A. considering that such income was received and retained by petitioner's permanent establishment in the Philippines through its agent Guia S. Hernandez <u>for reinvestments</u>. This fact is admitted by petitioner, through its representative, the SGV and Co., in its letter dated June 25, 1992 (Exh. "3", Respondent, pp. 84-86, BIR records).

In fine therefore, since petitioner has a permanent establishment in the Philippines and that there is no actual outward remittance of the interest income derived by petitioner from its Central Bank Special Series Bills during the period under review, petitioner herein cannot validly invoke the benefits under Article 12 of RP-US Tax Treaty as the basis of its claim for refund.

Perforce, since the 20% final withholding tax withheld and paid by the Central Bank on petitioner's aforesaid interest income was

> valid and proper, petitioner's claim for refund/tax credit in the instant case has no basis in the fact and in law, hence, should be denied."

This Court rules for the respondent.

It is true that respondent issued a ruling (B.I.R. Ruling 103-89; Annex "H"; C.T.A. Records, p. 60) that petitioner is entitled to a preferential rate of 15% final tax on interest derived from CBSSB's under the debt to equity conversion provision of C.B. Circular No. III. However, in that ruling, the question of permanent establishment was not in issue. Said ruling was issued merely upon representation of the petitioner that it is indeed a corporation organized and existing under the laws of State of Delaware, U.S.A. No mention was made as to its business activity in the Philippines.

Furthermore, it is a well-setled doctrine that notwithstanding respondent's issuance of a ruling, government can not be estopped in collecting taxes. Estoppel does not lie against the government. Erroneous application and unenforcement of the law by public officials do not block subsequent correct application of the statute and that the government is never stopped by error or mistake committed by its officials (**Commissioner of Internal Revenue vs. Proctor and Gamble PMC**, 160 SCRA 560; **Cruz, Jr. vs. Court of Appeals**, 194 SCRA 145)

Petitioner would like this Court to believe that it has no permanent establishment in the Philippines considering that its agent in the Philippines is of independent status. We do not believe so. Pursuant to the requirement of paragraphs 4(a) and 5 of Article 5 of RP-US Tax Treaty, you may be considered as having a permanent establishment if there is a person acting in one of contracting states on behalf of a resident of the other contracting state and such person has habitually exercised an authority to conclude contracts in the name of that resident. This situation will not apply if such representative is a broker, general commission agent or any other agent of an independent status, where such broker or agent is acting in the ordinary course of his business. The agent shall not be considered independent if the activities of such agent are devoted wholly or almost wholly on behalf of that resident.

Let us examine the facts of the case as shown from the records. Petitioner on May 17, 1989 appointed Robert R. Davis, Rodolfo B. Ordona and Guia S. Hernandez in their individual capacity as agent and attorney-in-fact (Exh. "2"). In accordance with the said power of attorney, the said agents are empowered to (1) manage the fund's assets, back accounts and investments of the petitioner (2) converting the fund's assets into equity investments. In connection with the said functions, the attorneys or any one of them are authorized to execute documents, provide notices and register documents on behalf of the fund. One of the agents, Ms. Guia S. Hernandez testified on August 21, 1991 that she is the Assistant Vice-President for Credit and Marketing Department of Security Pacific National Bank. As Assistant Vice-President she runs the credit department and market the banks services. In addition she was also designated to administer and manage the assets of the Philippine Fund, Inc. Please note that petitioner, Philippine Fund is wholly owned by Security Pacific Overseas Corporation which in turn is a wholly owned subsidiary of Security Pacific National Bank, an offshore banking unit operating in the Philippines (Exhs. "1-C" and "4", pp. 90,92 and 93 BIR Records).

Thus the agents representing the petitioner are with authority to conclude contracts as they are specifically authorized to execute documents under the power of attorney and therefore could qualify as a permanent establishment. They could not qualify as an independent agent. This court believes that the agents referred to in the tax treaty are those in the same category as commission agent or broker. This is in accordance with the principle of *ejusdem generis.* Under this principle on statutory construction where general terms follow the designation of particular things or classes of persons or subjects, the general terms will be construed to include those things or person of the same class of the same nature as those specifically enumerated (Handbook on Statutory Construction by Ruperto G. Martin, 1973 ed. p. 70). This conclusion is supported by the fact that the treaty provision requires this agent to be "acting in the ordinary course of his business". So the business of this person or entity are commission agent or broker and they are acting as such to the general public. The agents of the petitioner in our case could not qualify as an agent of independent status considering that they are employees of a banking institution whose duties are entirely different form the assigned task as agent of the petitioner. For instance, Mrs. Hernandez runs the credit and marketing department of the bank. She admitted that the administration of the assets of the petitioner is an additional function and in fact she is designated there in her individual capacity. She is neither a commission agent, a broker nor an independent agent acting in the pursuit of such business. The independency is even questionable inasmuch as the company where she is employed indirectly owned 100% of petitioner. Granting that she is an independent agent, it appears that her activities as an agent are devoted wholly or almost wholly on behalf of that resident and as explained in the next paragraph the transaction between the agent and the petitioner does not seem to be under arm's length condition. Therefore, she could not be considered as an agent with independent status pursuant to Article 5 of the said tax treaty.

It is worthy to note that the special power of attorney executed by the petitioner in favor of its agent has already expired on December 31, 1989 (Exhibit "J", C.T.A. Records, p. 65). Petitioner did not explain to the satisfaction of this Court why its agent still holds on to the interest income received in its behalf despite the expiration of the contract of agency. Since no remittance was ever made to the foreign corporation, it only proves that indeed petitioner has permanent establishment in the Philippines which makes it unqualified to avail of the preferential rate of 15% as provided for under the RP-US Tax Treaty.

Tax refund partakes of the nature of a tax exemption and therefore cannot be allowed unless granted in the most explicit and categorical language. The grant of refund privileges must be strictly construed against the taxpayer. (Insular Lumber Co. vs. Court of Tax Appeals, 104 SCRA 710; Commissioner of Internal Revenue vs. Rio Tuba Nickel Mining Corporation, 207 SCRA 549)

WHEREFORE, in view of all the foregoing considerations, the instant petition for review is hereby denied for lack of merit.

SO ORDERED.

Quezon City, Metro Manila, May 13, 1994.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

MANUEL K. GRUBA
Associate Judge

RAMON O. DE VEYRA
Associate Judge
(on leave)

CERTIFICATION

I hereby certify that the 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.

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals