REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE, Petitioner,	**C.T.A. E.B. NO. 5** **(C.T.A. CASE NO. 6139)**
	Present:
- versus -	**ACOSTA,** *P.J.* **CASTAÑEDA, JR.,** **BAUTISTA,** **UY,** **CASANOVA,** *and* **PALANCA-ENRIQUEZ,** *JJ.*
MITSUBISHI CORPORATION-MANILA BRANCH, Respondent.	**Promulgated:** MAY 2 4 2006

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DECISION

UY, J.:

This is a petition for review of the Decision promulgated on December 17, 2003 of the then Court of Tax Appeals (the Court in Division) brought to the Court of Tax Appeals En Banc (the Court En Banc) pursuant to Section 11 of Republic Act No. 9282, the dispositive portion of which reads as follows:

> "**WHEREFORE**, in the light of the foregoing, petitioner's claim for refund is **GRANTED**. Respondent Commissioner of Internal Revenue is hereby **ORDERED** to **REFUND** to petitioner the amount(s) of P44,288,712.00 and P8,324,100.00 representing

erroneously paid income tax and branch profit remittance tax, respectively.

No pronouncement as to cost.

SO ORDERED."

Aggrieved by the aforesaid decision, herein petitioner filed a timely motion for reconsideration and in a Resolution dated April 23, 2004, the Court in Division dismissed said motion for lack of merit. Hence, this appeal to the Court En Banc.

For better appreciation of the facts established, the issues raised and the proceedings had in this case, this Court deems it apropos to briefly summarize hereunder what it finds to be uncontroverted matters, to wit:

> Through an Exchange of Notes between the Government of Japan and the Government of the Philippines dated June 11, 1987, it was agreed that a loan amounting to Forty Billion Four Hundred Million Japanese Yen (Y40,400,000,000) will be extended to the Republic of the Philippines by the then Overseas Economic Cooperation Fund (OECF), (now the Japan Bank for International Cooperation or JBIC) for the implementation of the Calaca II Coal-Fired Thermal Power Plant Project (Calaca II Project).
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> Pursuant to the Exchange of Notes, particularly paragraph 5(2), "The Government of the Republic of the Philippines, will, itself or through its instrumentalities, assume all fiscal levies or taxes imposed in the Republic of the Philippines on Japanese firms and nationals operating as suppliers, contractors or consultants on and/or in connection with any income that may accrue from the supply of products of Japan and services of Japanese nationals to be provided under the Loan"
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> Consequently, the OECF and the Government of the Republic of the Philippines entered into a Loan Agreement (Loan Agreement No. PH-P76) dated September 25, 1987 for Forty Billion Four Hundred Million Japanese Yen (Y40,400,000,000) for the implementation of the Calaca II Project.
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> On June 21, 1991, the National Power Corporation (NPC, for brevity) and Mitsubishi Corporation, herein respondent's head office in Japan, entered into a contract for the engineering, supply,

construction, installation, testing and commissioning of one (1) x 300 MW Batangas Coal-Fired Thermal Power Project II at Calaca, Batangas (Calaca II Coal-Fired Thermal Power Project) (Contract, for brevity).

Article VI of the Contract provided that "The Foreign Currency Portion of the Contract Price for Phase I is funded by OECF Loan No. PH-P76. Any Foreign currency Portion of the Contract which is not covered by OECF Loan No. PH-P76 shall constitute as Phase II of the Contract. NPC shall secure additional financing from OECF for Phase II within one (1) year after the date of Contract effectivity."

Thus, a second loan agreement (Loan Agreement No. PH-P141) dated December 20, 1994 for the amount of Five Billion Five Hundred Thirteen Million Japanese Yen (Y5,513,000,000.00) was entered into between the OECF and the Government of the Republic of the Philippines for the additional funding of the Calaca II Project.

The Calaca II Project was completed by herein respondent on December 2, 1995 but was only accepted by NPC on January 31, 1998 through a Certificate of Completion and Final Acceptance dated February 4, 1998.

On July 15, 1998, herein respondent filed its Income Tax Return for the fiscal year ended March 31, 1998 with the Bureau of Internal Revenue. In the return, respondent, being the Manila Branch of Mitsubishi Corporation, reported an income tax due of P90,481,711.00.

In computing the P90,481,711.00 income tax due for the fiscal year ended March 31, 1998, herein respondent included as part of its taxable income, all revenue earned and cost incurred for its Calaca II Project, in accordance with the completed contract method of reporting income.

Likewise, on July 15, 1998, herein respondent filed its Monthly Remittance Return of Income Taxes Withheld and remitted the amount of P8,324,100 representing its branch profit remittance tax (BRPT) for branch profits remitted to its Head Office in Japan out of its income for the fiscal year ended March 31, 1998. The tax rate used was 10% in accordance with the Philippines-Japan Tax Treaty.

On September 7, 1998, herein petitioner issued Bureau of Internal Revenue Ruling No. DA-407-98 and declared that "Mitsubishi has no liability for income tax and other taxes and fiscal levies, including VAT, xxx on the 100% of its foreign currency portion of the Calaca II Project since the said taxes were assumed by the Philippine Government.

On June 30, 2000, respondent filed an administrative claim for refund and/or tax credit with herein petitioner in the amount of P52,612,812.00, representing its erroneously paid income tax in the amount of P44,288,712 and erroneously paid branch profit remittance

> tax in the amount of P8,324,100.00 corresponding to the OECF-funded portion of its Calaca II Project.
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> On July 13, 2000, respondent filed a petition for review with the Court's Division pursuant to Section 229 of the 1997 National Internal Revenue Code, in order to suspend the running of the two-year period within which to file a judicial claim for refund.
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> On December 17, 2003, a Decision was rendered by the Court's Division granting the respondent's claim for refund and ordering petitioner to refund to the respondent the amounts of P44,288,712.00 and P8,324,100.00, representing erroneously paid income tax and branch profit remittance tax, respectively. Thereafter, petitioner filed a Motion for Reconsideration. The Court's Division rendered on April 23, 2004, its Resolution dismissing petitioner's motion for reconsideration for lack of merit.

At the outset, this Court is well aware of the significance and far-reaching implication of its decision in this case as it deals with the Philippine Government's relationship not only with its citizens but with a foreign government and foreign entities as well.

Brought before this Court is a lone issue of "whether or not respondent is entitled to the claim for refund".

More specifically stated: Is respondent Mitsubishi Corporation – Manila Branch entitled to a refund of the taxes it allegedly paid to the petitioner Commissioner of Internal Revenue in the amounts of P44,288,712.00 and P8,324,100.00 as erroneously paid income tax and branch profit remittance tax, respectively, invoking the provisions under the EXCHANGE OF NOTES between the Government of Japan and the Government of the Philippines (hereafter referred as Exchange of Notes), the BIR Ruling numbered DA-407-98, and Sections 204 and 229 of the National Internal Revenue Code (NIRC) of 1997?

This Court rules in the negative.

The power of taxation is an incident of sovereignty as it is inherent in the State, belonging as a matter of right to every independent government. It does not need a constitutional conferment. Constitutional provisions do not give rise to the power to tax but merely impose limitations on what would otherwise be an invincible power. No attribute of sovereignty is more pervading and at no point does the power of the government affect more constantly and intimately all the relations of life than through the exactions made under it.[1]

It is considered inherent in a sovereign state being a necessary attribute of sovereignty. For indeed, taxes are the lifeblood of every independent government.

In the language of the Supreme Court, "the power of taxation is a high prerogative of sovereignty, the relinquishment is never presumed and any reduction or diminution thereof with respect to its mode or its rate, must be strictly construed, and the same must be coached in clear and unmistakable terms in order that it may be applied."[2]

Our courts are uniform and consistent in stressing and restressing that tax refunds are in the nature of tax exemptions.[3] And, in this connection, the present Constitution is explicit in providing stringent

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[1] Churchill vs. Concepcion, 34 Phil. 969 (1916); Cooley, Constitutional Limitations, 6th Ed., p.587.
[2] Luzon Stevedoring Corporation vs. Court of Tax Appeals, 163 SCRA 647 (1988).
[3] Commissioner of Internal Revenue vs. Procter and Gamble Philippine Manufacturing Corporation, 204 SCRA 377 (1991).

proscriptions on the matter of tax relinquishment or tax exemptions. Thus, Section 28 (4) of Article VI provides:

> "No law granting any tax exemption shall be passed without the concurrence of a majority of all the Members of the Congress."

Putting flesh to the aforequoted constitutional provision, Sections 204 and 229 of the NIRC of 1997 provide the procedures, requirements and its applicability in claiming tax refunds arising out of erroneous or wrongful collections, quoted hereunder for easy reference, to wit:

> "**SEC. 204. Authority of the Commissioner to Compromise, Abate and Refund or Credit Taxes.** -- The Commissioner may --
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> xxx xxx xxx
>
> (C) Credit or refund taxes erroneously or illegally received or penalties imposed without authority, refund the value of internal revenue stamps when they are returned in good condition by the purchaser, and, in his discretion, redeem or change unused stamps that have been rendered unfit for use and refund their value upon proof of destruction. No credit or refund of taxes or penalties shall be allowed unless the taxpayer files in writing with the Commissioner a claim for credit or refund within two (2) years after the payment of the tax or penalty: x x x"

> "**SEC. 229. Recovery of Tax Erroneously or Illegally Collected.** -- No suit or proceeding shall be maintained in any court for the recovery of any national internal revenue tax hereafter <u>alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessively or in any manner wrongfully collected</u>, until a claim for refund or credit has been duly filed with the Commissioner; but such suit or proceeding may be maintained, whether or not such tax, penalty, or sum has been paid under protest or duress.
>
> In any case, no such suit or proceeding shall be filed after the expiration of two (2) years from the date of payment of the tax or penalty regardless of any supervening cause that may arise after payment: x x x" (Underscoring ours)

In the light of the foregoing principles of law, this Court **DENIES** the claim for refund of the respondent for the following reasons:

The Exchange of Notes only provides for the assumption of tax liabilities by the Philippine Government through its executing government agency, in this case, the National Power Corporation (NPC)

It is undisputed that the Exchange of Notes did not grant any tax exemption in favor of the Japanese firms or nationals. No less than the respondent itself has admitted that the Exchange of Notes is not a grant of tax exemption. This is patently clear when the respondent anchored its claim for refund on BIR Ruling No. DA-407-98 which is cast in the following tenor:

> "In reply, please be informed that the aforequoted provisions of Notes-NAIA and Notes-Calaca are not grants of direct tax exemption privilege to the Japanese firms . . . because the said provisions state that it is the Government of the Republic of the Philippines that is obligated to pay whatever fiscal levies or taxes they may be liable to. **Thus there is no tax exemption to speak of because the said taxes shall be assumed by the Philippine Government**; hence the said provision is not violative of the Constitutional prohibition against grants of tax exemption without the concurrence of the majority of the members of Congress (BIR Ruling No. 071-97 citing Sec. 28(4), Art. VI, 1987 Philippine Constitution).
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> In view thereof, and considering that the estimated contribution of the Government of Japan is Y18,120,000,000.00 in the NAIA II Project and Y40,400,000,000.00 in the Calaca II Project and that the beneficiary is the Philippine Government, this office is of the opinion and hereby holds that Mitsubishi has no liability for income tax and other taxes and fiscal levies, including VAT, on the 75% of the NAIA II Project and on the 100% of the foreign currency portion of the Calaca II Project since the said taxes were assumed by the Philippine Government."[4] (Emphasis Ours)

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[4] Exhibit "K", CTA Case No. 6139.

The aforequoted ruling coached in clear and unequivocal terms states that the Exchange of Notes grants no tax exemption. It merely provides for the assumption of tax liabilities by the Philippine Government through its government executing agency.

Such being the case, this Court is persuaded to take note of the observations and explanations narrated in the Dissenting Opinion in C.T.A. Case No. 6139, wherein it pointed out that the tax assumption mentioned in the Exchange of Notes is not the same as tax exemption. Consequently, respondent cannot rely on Section 229 of the NIRC of 1997 as basis for the refund of taxes it paid. The material portion of said Dissenting Opinion, which We hereby adopt as part of this decision, aptly stated:

> "The above-cited section speaks of taxes erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessively or in any manner wrongfully collected. Undeniably, **it is not proper for us to allow a claim for refund in favor of petitioner who, by law, is legally mandated to pay the taxes due from it. The allegation of petitioner that the subject taxes it paid comes within the purview of an erroneous payment merely because said taxes, by virtue of a contract, are to be assumed by NPC is unavailing.**
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> It is a basic principle in civil law that with certain exceptions not obtaining in this case, a contract can only bind the parties who had entered into it or their successors who assumed their personalities or their juridical positions, and that, as a consequence, such contract can neither favor nor prejudice a third person (Ouano vs. Court of Appeals, G.R. No. 95900, July 23, 1992). Article 1311 of the Civil Code of the Philippines provides that 'Contracts take effect only between the parties, their assigns and heirs, except in case where the rights and obligations arising from the contract are not transmissible by their nature, or by stipulation or by provision of law.' This is the principle of relativity of contracts.

> In the case at bar, it is undisputed that the contract was entered into only by and between the parties (NPC and herein petitioner) and the herein respondent was neither a party thereto nor was he aware of the provision thereof. **Thus, respondent should not be made to observe the term of the contract between the parties, otherwise, the principle of relativity of contracts, long enshrined in our substantive laws, will be violated.**
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> **The 'assumption of taxes' clause in the Contract between the petitioner and NPC is not enough to put petitioner's case within the operation of Section 229 of the Tax Code. The payments of petitioner to respondent of the income taxes and the BPRT were made legally by it and the Contract is not enough ground to grant petitioner's claim for refund. A contract is, as always, subordinate to the law**."[5] (Emphasis ours)

Indubitably, the provision of Section 229 does not apply to those claimants who, by law, are legally mandated to pay the taxes due from them.

This Court, therefore, is possessed with no power to grant the refund under Sec. 229 of the NIRC of 1997 since, after all, no tax exemption is granted under the Exchange of Notes.

Moreover, respondent relies on BIR Ruling DA-407-98 dated September 7, 1998 as the basis for its claim for refund. The ruling stated that the Exchange of Notes provides for the assumption of tax liabilities by the Philippine Government and respondent Mitsubishi has no liability for income tax and other taxes since the said taxes were assumed by the Philippine Government. Nowhere could We find any statement that would indicate that the taxes paid by the respondent should be refunded by the Bureau of Internal Revenue itself.

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[5] Dissenting Opinion, CTA Case No. 6139, December 17, 2003.

In reiteration, We find that respondent miserably failed to establish that the payments of the subject taxes to the petitioner was erroneous within the contemplation of law which would justify its claim under the remedy and proceedings availed of by it.

There are constitutional provisions that prohibit the grant of tax exemption under such Exchange of Notes and only treaties can grant income tax exemption

Before delving with the constitutional proscriptions against the grant of tax exemption, We look into the nature of "Exchange of Notes", the relationship it creates between or among the parties thereto, as compared to a treaty.

"Exchange of Notes", is defined as "an informal method whereby States subscribe to certain understandings or recognize certain obligations as binding upon them. Agreements on matters of minor importance are frequently made by means of formal notes exchanged between the Minister for Foreign Affairs, acting for his government, and the resident diplomatic representative of the other country, similarly authorized".[6] (Underscoring Ours)

"A treaty, as defined by the Vienna Convention on the Law of Treaties, is 'an international instrument concluded between States in written form and governed by international law, whether embodied in a

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[6] Salonga and Yap, Public International Law, 4th Ed., p.304.

single instrument or in two or more related instruments, and whatever its particular designation'. There are many other terms used for a treaty or international agreement, some of which are: act, protocol, agreement, compromis d' arbitrage, concordat, convention, declaration, exchange of notes, pact, statute, charter and modus vivendi. xxx"[7] (Underscoring Ours)

Thus, it could readily be observed that a treaty could take the form of a mere agreement or even an "Exchange of Notes".

Moreover, the Supreme Court had the occasion to express:

> "Thus, in international law, there is no difference between treaties and executive agreements in their binding effect upon states concerned, as long as the negotiating functionaries have remained within their powers. xxx"[8] (Underscoring ours)

This therefore leads Us to the question of whether the subject Exchange of Notes under the facts obtaining could validly grant a tax exemption to respondent.

Again, We rule in the negative.

The power of taxation is inherently a legislative power and a legislative prerogative. This is based upon the principle that "taxes are a grant of the people who are taxed, and the grant must be made by the immediate representatives of the people. And where the people have laid the power, there it must remain and be exercised."[9]

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[7] Bayan (Bagong Alyansang Makabayan), et al. vs. Executive Secretary Zamora, et al., 342 SCRA 449 (2000).
[8] Ibid, p.489; citing Hackworth, Digest of International Law, Vol. 5, p.395.
[9] 1 Cooley Taxation, 3rd Ed., p.43.

This principle finds a stronghold in no less than our fundamental law. The constitutional provisions relevant to the case before Us are Section 21 of Article VII (Executive Department) and Section 28 (4) of Art. VI (Legislative Department) of the 1987 Constitution of the Philippines, quoted hereunder to wit:

Section 21 of Article VII:

> "No treaty or international agreement shall be valid and effective unless concurred in by at least two-thirds of all the Members of the Senate."

Section 28 (4) of Article VI:

> "No law granting any tax exemption shall be passed without the concurrence of a majority of all the Members of the Congress."

The above-cited provisions must be read in relation to Section 32 (B) (5) of the NIRC of 1997 which provides that tax exemptions may be granted only through treaties entered into by the Government of the Philippines and other sovereign states. Sec. 32 (B) (5), in part, reads:

> ***"Sec. 32. Gross Income. —***
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> xxx xxx xxx
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> (B) **Exclusions from Gross Income.** — The following items shall not be included in gross income and shall be exempt from taxation under this Title:
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> xxx xxx xxx
>
> (5) **Income Exempt under Treaty.** — Income of any kind, to the extent required by any treaty obligation binding upon the Government of the Philippines.

Section 21 of Article VII of the Constitution requires the concurrence of two-thirds (2/3) of all the members of the Senate for the validity of any treaty or international agreement. In this regard, there is no showing that the Exchange of Notes was approved by at least two-thirds of the entire Senate membership. Hence, the Exchange of Notes is definitely not a treaty.

The Exchange of Notes may be a valid executive agreement but certainly not for the purpose of granting tax exemptions which can only be done through a treaty with the concurrence of two-thirds (2/3) of the entire Senate membership pursuant to Section 21 of Article VII of the Constitution in relation to Section 32 (B) (5) of the 1997 NIRC.

It maybe recalled that in the *Bayan case*, it was stressed that while in our jurisdiction, we have recognized the binding effect of executive agreements even without the concurrence of the Senate or Congress, it nevertheless highlighted the fact that as to "tax treaties", the concurrence of at least two-thirds (2/3) of all the members of the Senate is required to make the subject treaty or international agreement binding on the part of the Philippines.

Thus, the Supreme Court in said case elaborated:

> "Section 21, Article VII deals with treaties or international agreements in general, in which case, the concurrence of at least two-thirds (2/3) of all the members of the Senate is required to make the subject treaty, or international agreement, valid and binding on the part of the Philippines. This provision lays down the general rule on treaties or international agreements and applies to any form of treaty with a wide variety of subject matter, such as, but not limited to, extradition or tax treaties or those economic in nature. All treaties or

> international agreements entered into by the Philippines, regardless of subject matter, coverage, or particular designation or appellation, requires the concurrence of the Senate to be valid and effective."[10] (Underscoring ours)

On the other hand, while the Supreme Court had invoked some executive agreements like "Exchange of Notes" to have binding effect on the parties even without congressional approval, yet, it was not remiss in stating by way of enumeration the subject matters of such agreement, when it said:

> ". . . the right of the Executive to enter into binding agreements without the necessity of subsequent Congressional approval has been confirmed by long usage. From the earliest days of our history we have entered into executive agreement covering such subjects as commercial and consular relations, most-favored-nation rights, patent rights, trademark and copyright protection, postal and navigation arrangements and the settlement of claims. The validity of these has never been seriously questioned by our courts."[11]

It could therefore be seen with pristine clarity, that while our Supreme Court recognizes some international agreements as purely and exclusively an executive function, yet, "agreements" or "treaties" on matters dealing with taxes require, as a condition to its binding effect, the congressional fiat as mandated in our present Constitution.

It must be stressed that in the enumeration of agreements cited by the Supreme Court which were given binding-effects sans the concurrence of the Senate, they only referred to matters of "minor importance" which by practice and convenience fall within the routinary functions of the Executive Department. This is further bolstered by the definition of "Exchange of Notes" provided by a known authority on

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[10] Supra., p.482.
[11] The Commissioner of Customs vs. Eastern Sea Trading, 3 SCRA 351 (1961).

Constitutional Law, former Senator Jovito R. Salonga, in his book *Public International Law.*[12]

The clear explanation why treaties or international agreements dealing with taxes, particularly the grant of tax exemptions, mandate congressional concurrence is that our present Constitution is not only expressive on the matter but empathic in providing specific limitations. Understandably, because the power of taxation including its ramifications is inherently a legislative prerogative.

The other constitutional provision, reflecting the intent of its framers which indicates strictness on matters of tax exemptions, is Section 28 (4) of Article VI which requires the assent of an absolute majority of all the Members of Congress in the passage of any law dealing with tax exemptions. This provision indicates that tax exemptions are not to be frivolously granted even by Congress, the branch of government that is vested with the power of taxation.

A mere executive agreement in the form of "Exchange of Notes", *a fortiori*, cannot grant tax exemptions. Such agreement assuming the mere form of an "Exchange of Notes" cannot be used to circumvent our Constitution and laws. It may also be mentioned in this connection, that the grant of tax exemptions is not within the powers of the President.

In a very recent case,[13] the Supreme Court explained:

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[12] Supra., p. 304.
[13] Coconut Oil Refiners Association, Inc. vs. Torres, 465 SCRA 47 (2005).

"In that case, among the arguments raised was that the granting of tax exemptions to John Hay was an invalid and illegal exercise by the President of the powers granted only to the Legislature. Petitioners therein argued that Republic Act No 7227 expressly granted tax exemption only to Subic and not to the other economic zones yet to be established. **Thus, the grant of tax exemption to John Hay by Presidential Proclamation contravenes the constitutional mandate** that '[n]o law granting any tax exemption shall be passed without the concurrence of a majority of all the members of Congress.'

This Court sustained the argument and ruled that the incentives under Republic Act No. 7227 are exclusive only to the SSEZ. **The President, therefore, had no authority to extend their application to John Hay**. To quote from the Decision:

> 'More importantly, the nature of most of the assailed privileges is one of tax exemption. It is the legislature, unless limited by a provision of the state constitution, that has full power to exempt any person or corporation or class of property from taxation, its power to exempt being as broad as its power to tax. Other than Congress, the Constitution may itself provide for specific tax exemptions, or local governments may pass ordinances on exemption only from local taxes.
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> The challenged grant of tax exemption would circumvent the Constitution's imposition that a law granting any tax exemption must have the concurrence of a majority of all the members of Congress. In the same vein, other kinds of privileges extended to the John Hay SEZ are by tradition and usage for Congress to legislate upon.
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> Contrary to public respondent's suggestions, the claimed statutory exemption of the John Hay SEZ from taxation should be manifest and unmistakable from the language of the law on which it is based; it must be expressly granted in a statute stated in a language too clear to be mistaken. Tax exemption cannot be implied as it must be categorically and unmistakably expressed.
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> If it were the intent of the legislature to grant to John Hay SEZ the same tax exemption and incentives given to the Subic SEZ, it would have so expressly provided in R.A. No. 7227'."[14] (Emphasis ours)

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[14] John Hay Peoples Alternative Coalition vs. Lim, 414 SCRA 356 (2003).

Revenue Memorandum Circular No. 42-99 Provides the Proper Remedy

As already mentioned earlier, the proper remedy available to the respondent is already provided for under RMC No. 42-99 dated June 2, 1999. The pertinent provision reads:

> "B) INCOME TAX
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> 3. **In cases where income taxes were previously paid** directly by the Japanese contractors or nationals, **the corresponding cash refund shall be recovered from the government executing agencies** upon the presentation of proof of payment thereof by the Japanese contractors or nationals". (Emphasis Ours)

It is clear from the aforecited provision of RMC No. 42-99 that the respondent should recover from the government executing agency (the NPC), not from the Commissioner of Internal Revenue.

"When an administrative agency renders an opinion by means of a circular or memorandum it merely interprets a pre-existing law and no publication is required for its validity".[15] It should be noted that RMC No. 42-99 was issued on June 2, 1999. Respondent herein filed its administrative claim for refund with the Bureau of Internal Revenue only on June 30, 2000 and its Petition for Review with the Court in Division on July 13, 2000. Therefore, RMC No. 42-99 is already in effect at the time of filing of respondent's administrative claim for refund on June 30, 2000.

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[15] Romualdez vs. Arca, et al., L-25924, April 18, 1969, cited in La Suerte Cigar & Cigarette Factory, et al., vs. Court of Tax Appeals, et al., L-36130, and Alhambra Industries, Inc., et al vs. Court of Tax Appeals, L-36131, jointly decided on January 17, 1885.

Moreover, Section B (3) of RMC No. 42-99 expressly provides that it shall particularly apply to recovery of taxes that "were previously paid directly by the Japanese Contractors or nationals" which means that the provision shall apply even though the tax returns have already been filed and the taxes paid before RMC No. 42-99 was issued. We would like to emphasize that what should be considered, in relation to the prospective application of an administrative rule or regulation, is the date of filing of the administrative claim for refund. In conclusion therefore, if ever respondent is entitled to a refund, it is through the remedy clearly prescribed under RMC No. 42-99 and not under Section 229 of the NIRC of 1997 as invoked by respondent herein.

International Comity May Not Be Invoked

It is worth mentioning in this connection, that this Court in rendering this decision does not give a license to the Philippine Government to violate its international commitments. We are not unmindful of the dire consequences of any judicial indiscretion which would adversely affect this country's standing in our international relations.

On the contrary, by this decision, the Court aptly provides an ample remedy to respondent to enforce its contract as envisioned under the subject Exchange of Notes. Impeccably, the Philippine Government does not renege from its international commitment. This could be gleaned from the provisions of RMC No. 42-99.

Since the Philippine Government does not turn its back from its assumed obligations under the Exchange of Notes, there is no violation of any international agreement and, therefore, the matter of comity among nations is not affected in the instant petition.

And even if this international doctrine of comity comes into play, We must not lose sight of the guidepost provided by the Supreme Court, when it said:

> "Definitely, the taxability of a party cannot be blandly glossed over on the basis of a supposed 'broad, pragmatic analysis' alone without substantial supportive evidence, lest governmental operations suffer due to diminution of much needed funds. Nor can we close this discussion without taking cognizance of petitioner's warning, of pervasive relevance at this time, that while international comity is invoked in this case on the nebulous representation that the funds involved in the loans are those of a foreign government, scrupulous care must be taken to avoid opening the floodgates to the violation of our tax laws. Otherwise, the mere expedient of having a Philippine corporation enter into a contract for loans or other domestic securities with private foreign entities, which in turn will negotiate independently with their governments, could be availed of to take advantage of the tax exemption law under discussion."[16]

In fine, the petitioner cannot be compelled by this Court to refund the taxes paid by the respondent, after all, the Exchange of Notes did not grant any tax exemption to the respondent. In fact, BIR Ruling DA-407-98 declared that there is no tax exemption to speak of. Therefore, there is no erroneous or illegal payment of taxes that would fall within the purview of Section 229 of the 1997 NIRC. Moreover, the proper

[16] Commissioner of Internal Revenue vs. Mitsubishi Metal Corporation, 181 SCRA 82 (1990).

remedy for the respondent is to seek recovery from the NPC as provided in RMC No. 42-99, in view of NPC's assumption of respondent's tax liabilities.

The rule in this jurisdiction to which our jurisprudence clung with unrelenting grasp is that "[t]ax refunds are in the nature of tax exemptions. As such, they are regarded as in derogation of sovereign authority and to be construed strictissimi juris against the person claiming the exemption."[17]

Another point worth discussing is the matter raised by respondent in its Comment regarding the petitioner's failure to attach the certification of non-forum shopping to his petition for review. This has already been properly addressed by the Court En Banc in its Resolution dated December 15, 2004 and has been complied with by the petitioner on December 20, 2004. The Court's acceptance of a belatedly filed certification of non-forum shopping finds support in the Supreme Court's recent ruling in the case of ***China Banking Corporation vs. Mondragon International Phils., Inc.***, wherein it relaxed, under justifiable circumstances, the rule requiring the submission of these certifications and has applied the rule of substantial compliance under justifiable circumstances with respect to the contents of the certification. Moreover, the Supreme Court has conceded that it allows the belated

[17] Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc. et al., 209 SCRA 87 (1999).

filing of the certification against forum shopping for compelling reasons in its previous rulings.[18]

Likewise, respondent's assertion that petitioner "cannot raise defenses for the first time on appeal" because the arguments advanced in his Petition for Review with this Court were not raised during the trial of this case does not convince Us.

It bears stressing that this Court acquired jurisdiction over the case because respondent filed a judicial claim for refund. Thus, after acquiring jurisdiction, the Court has the duty to determine whether or not the respondent under the facts as duly established, is entitled to its claimed refund; and in the process, the Court, by necessity, has to determine **the nature, character and propriety of the tax collection** in relation to the subject Exchange of Notes and whether or not it erroneously paid the subject taxes. Undeniably, this is an inherent function of this Court.

After the lengthy and exhaustive discussion of the issue raised in this case and its multiple aspects, We rule that the denial of the herein respondent's claim for refund is made in accordance with the established facts and the applicable laws.

WHEREFORE, the petition for review is hereby **GRANTED**. Accordingly, the **DECISION** and **RESOLUTION** dated December 17,

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[18] G.R. No. 164798, November 17, 2005; citing Ateneo De Naga University vs. Manalo, 458 SCRA 325 (2005).

2003 and April 23, 2004, respectively, in C.T.A. Case No. 6139 are hereby **REVERSED** and **SET ASIDE**.

Consequently, respondent's claim for refund in the amounts of P44,288,712.00 and P8,324,100.00 representing erroneously paid income tax and branch profit remittance tax, respectively, is hereby **DENIED**.

SO ORDERED.

ERLINDA P. UY
Associate Justice

WE CONCUR:

(Concurring with the Dissenting Opinion of Associate Justice Bautista)
ERNESTO D. ACOSTA
Presiding Justice

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice

(With Dissenting Opinion)
LOVELL R. BAUTISTA
Associate Justice

CAESAR A. CASANOVA
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution, it is hereby certified that the conclusions in the above decision were reached in consultation before the case was assigned to the writer of the opinion of the Court *En Banc*.

ERNESTO D. ACOSTA
Presiding Justice

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

C.T.A. EB No. 5
(C.T.A. Case No. 6139)

Present:

-versus-

Acosta, P.J.
Castañeda, Jr.
Bautista,
Uy,
Casanova, and
Palanca-Enriquez, JJ.

MITSUBISHI CORPORATION-MANILA BRANCH,
Respondent.

Promulgated:
MAY 2 4 2006 GAApolinario

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DISSENTING OPINION

BAUTISTA, J.:

I am constrained to register my dissent to the opinion espoused by my esteemed colleagues.

The majority favored the denial of respondent's, Mitsubishi Corporation-Manila Branch, claim for refund of alleged erroneously paid income tax and branch profit remittance tax because it is not exempt from the payment of taxes and thus, there was no erroneous nor illegal payment of taxes to warrant the application of Section 229 of the National Internal Revenue Code of 1997.

In the present case, the Governments of Japan and the Philippines executed an Exchange of Notes whereby a loan was extended to the Republic of the Philippines by the Overseas Economic Cooperation Fund (OECF) now Japan Bank of International Cooperation (JBIC) for the implementation of the Calaca II Coal-Fired Thermal Power Plant Project. Relevant portions of the Exchange of Notes dated June 11, 1987 are quoted hereunder:

> "5. (1) The Government of the Republic of the Philippines will exempt the Fund from all fiscal levies or taxes imposed in the Republic of the Philippines on and/or in connection with the Loan as well as interest accruing therefrom.
>
> (2) The Government of the Republic of the Philippines will, itself or through its executing agencies or instrumentalities, assume all fiscal levies or taxes imposed in the Republic of the Philippines on Japanese firms and nationals operating as suppliers, contractors or consultants on and/or in connection with any income that may accrue from the supply of products of Japan and services of Japanese nationals to be provided under the Loan." (Emphasis supplied)

Pursuant to the Exchange of Notes, the executing government agency, National Power Corporation (NPC), entered into a Contract with Mitsubishi Corporation, a corporation duly organized and existing under and by virtue of the laws of Japan, whereby the latter fully undertook the engineering, supply, construction, installation, testing and commissioning of steam generator and auxiliaries and associated civil works for one (1) x 300 mw Batangas-Coal-Fired Thermal Power Project II at Calaca, Batangas, Philippines[1] while NPC undertook

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[1] Contract for the Engineering, Supply, Construction, Installation, Testing and Commissioning of Steam Generator and Auxiliaries and Associated Civil Works for One (1) x 300 mw Batangas-Coal-Fired Thermal Power Project II at Calaca, Batangas, Philippines (Calaca II Coal-Fired Thermal Power Project)

to pay Mitsubishi Corporation the contract price. Under the said contract, NPC likewise undertook to pay any and all forms of taxes, which are directly imposable under the contract including VAT that may be imposed by the Philippine Government, or any of its agencies and political subdivisions.

While paragraph 5(2) of the Exchange of Notes merely provides an assumption by the Philippine Government of all fiscal levies or taxes imposed in the Philippines on Japanese firms and nationals operating as suppliers, contractors or consultants, the Court cannot disregard paragraph 5(1) of the Exchange of Notes that provides tax exemption. It clearly states that the Philippine Government will exempt the Fund from all fiscal levies or taxes imposed in the Philippines. Both the Governments of the Philippines and Japan intend the Fund to fully source the project and be free from whatever fiscal levies and taxes that may be imposed. The second paragraph finds application whenever there are subsequent fiscal levies or taxes imposed on Japanese firms and nationals. As expressly stated, the executing agency shall assume the obligation to pay such fiscal levies and taxes imposed.

The constitutional provisions cited by petitioner are not applicable in the instant case. Section 28(4), Article VI of the 1987 Constitution provides:

> "No law granting any tax exemption shall be passed without the concurrence of a majority of all the Members of Congress."

There is no question that the legislative power shall be vested in the Congress of the Philippines, which shall consist of a Senate and a House of Representative (Section 1, Article VI of the 1987 Constitution). But the power to legislate is not without limits. As aptly stated in the case of *Government of the Philippines Islands vs. Springer*[2]:

> "xxx In constitutional governments, however, as well as governments acting under delegated authority, the powers of each of the departments of the same are limited and confined within the four walls of the constitution or the charter, and each department can only exercise such powers as are expressly given and such other powers as are necessarily implied from the given powers. The Constitution is the shore of legislative enactment may dash, but over which it cannot leap."

Section 28(4), Article VI of the 1987 Constitution provides one of the limitations on the legislative power. As the power to tax includes the power to grant exemption, said provision clearly refers to the passage of laws that provide for tax exemptions.

The requirement of a qualified majority for the passage of tax exemption laws is an added limitation on the power to tax.[3] The Constitution requires the concurrence of a majority of all the members of Congress to pass a law granting any tax exemption (Sec. 28[4]). The reason is that taxation is the rule and exemption is the exception. The requirement is a safeguard against the indiscriminate grant of tax exemptions which results in loss of revenue to the government. xxx"[4]

What is involved in the present case is not a Philippine law that grants tax exemption but an Exchange of Notes, which was a valid exercise of an executive power enshrined in Our Constitution.

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[2] 50 Phil 259 [1927]
[3] Bernas, The Constitution of the Republic of the Philippines, A Commentary, 1988 ed., citing "Vanhorne's Lessee v. Dorrance, 2 Dall, 304, 308 (U.S. 1795), p.65
[4] Philippine Constitutional Law, Principles and Cases (Vol. II), 1999 ed., p. 213

Section 21, Article VII of the 1987 Constitution reads:

> "No treaty or international agreement shall be valid and effective unless concurred in by at least two-thirds of all the Members of the Senate."

Undoubtedly, the Exchange of Notes between the Republic of the Philippines and Japan constitutes a valid and binding international agreement. It is a valid source of tax exemption. While treaties of any kind, whether bilateral or multilateral, require Senate concurrence, there are other forms of international agreements into which the Chief Executive may enter. The authority of the Chief Executive to enter into executive agreements without concurrence of the legislature has traditionally been recognized in Philippine jurisprudence.

An exchange of notes is defined as "an informal method whereby States subscribe to certain understandings or recognized certain obligations as binding upon them. Agreements on matters of minor importance are frequently made by means of formal notes exchanged between the Minister for Foreign Affairs, acting for his government, and the resident diplomatic representative of the other country, similarly authorized."[5] Under international law, however, the term treaty embraces all kinds of international agreements, regardless of the nomenclature used to designate them.[6]

In the case of *Commissioner of Customs vs. Eastern Sea Trading*[7], the Supreme Court held:

> "The Court of Tax Appeals entertained doubts on the legality of the executive agreement sought to be implemented by Executive Order No. 328, owing to the fact that our Senate had not concurred in

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[5] *Salonga & Yap, Public International Law, 4th ed., p. 304.*
[6] *Salonga & Yap, Public International Law, 4th ed., p. 303.*
[7] *No. L-14279, October 31, 1961*

the making of said executive agreement. The concurrence of said House of Congress is required by our fundamental law in the making of "treaties" (Constitution of the Philippines, Article VII, Section 10[7]), which are, however, distinct and different from "executive agreements", which may be validly entered into without such concurrence.

"Treaties are formal documents which require ratification with the approval of two-thirds of the Senate. Executive agreements become binding through executive action without the need of a vote by the Senate or by Congress.

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" . . . the right of the Executive to enter into binding agreements without the necessity of subsequent Congressional approval has been confirmed by long usage. From the earliest days of our history we have entered into executive agreements covering such subjects as commercial and consular relations, most-favored-nation rights, patent rights, trademark and copyright protection, postal and navigation arrangements and the settlement of claims. The validity of these has never been seriously questioned by our courts.

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"Agreements with respect to the registration of trade-marks have been concluded by the Executive with various countries under the Act of Congress of March 3, 1881 (21 Stat. 502). Postal conventions regulating the reciprocal treatment of mail matters, money orders, parcel post, etc. have been concluded by the Post-master Congress beginning with the Act of February 20, 1792 (I Stat. 232, 239). Ten executive agreements were concluded by the President pursuant to the McKinley Tariff Act of 1890 (26 Stat. 567, 612), and nine such agreements were entered into under the Dingley Tariff Act of 1897 (30 Stat. 151, 203, 214). A very much larger number of agreements, along the lines of the one with Rumania previously referred to, providing for most-favored-nation treatment in customs and related matters have been entered into since the passage of the Tariff Act of 1922, not by direction of the Act but in harmony with it.

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"International agreements involving political issues or changes of national policy and those involving international arrangements of a permanent character usually take the form of treaties. But international agreements embodying adjustments of detail carrying out well-established national policies and traditions and those involving arrangement of a more or less temporary nature usually take the form of executive agreements.

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"Furthermore, the United States Supreme Court has expressly recognized the validity and constitutionality of executive agreements entered into without Senate approval." (39 Columbia Law Review, pp. 753-754) (See, also, U.S. vs. Curtis-Wright Export Corporation, 299 U.S. 304, 81 L. ed. 255; U.S. vs. Belmont, 301 U.S. 324, 81 L. ed. 1134; U.S. vs. Pink, 315 U.S. 203, 86 L. ed. 796; Ozanic vs. U.S. 188 F. 2d.288; Yale Law Journal, Vol. 15, pp. 1905-1906; California Law Review, Vol. 25, pp. 670-675; Hyde on International Law [Revised Edition], Vol. 2, pp. 1405, 1416-1418; Willoukhby on the U.S. Constitutional Law, Vol. I [2d.ed.], pp. 537-540; Moore, International Law Digest, vol. V, pp. 210-218; Hackworth, International Law Digest, Vol. V, pp. 390-407). (Emphasis supplied.)

"In this connection, Francis B. Sayre, former U.S. High Commissioner to the Philippines, said in his work on "The Constitutionality of Trade Agreement Acts":

"Agreements concluded by the President which fall short of treaties are commonly referred to as executive agreements and are no less common in our scheme of government than are the more formal instruments – treaties and conventions. They sometimes take the form of exchanges of notes and at other times that of more formal documents denominated 'agreements' or 'protocols'. The point where ordinary correspondence between this and other governments ends and agreements – whether denominated executive agreements or exchanges of notes or otherwise – begin, may sometimes be difficult of ready ascertainment. It would be useless to undertake to discuss here the large variety of executive agreements as such, concluded from time to time. Hundreds of executive agreements as such concluded from time to time. Hundreds of executive agreements, other than those entered into under the trade agreements act, have been negotiated with foreign governments. x x x It would seem to be sufficient, in order to show that the trade agreements under the Act of 1934 are not anomalous in character, that they are not treaties, and that they have abundant precedent in our history, to refer to certain classes of agreements heretofore entered into by the Executive without the approval of the Senate. They cover such subjects as the inspection of vessels, navigation dues, income tax on shipping profits, the admission of civil aircraft, customs matters, and commercial relations generally, international claims, postal matters, the registration of trade-marks and copyrights, etcetera. Some of them were concluded not by specific congressional authorization but in conformity with policies declared in acts of Congress with respect to the general subject matter, such as tariff acts; while still others, particularly those with respect of the settlement of claims against foreign governments, were concluded independently of any legislation." (39 Columbia Law Review, pp. 651, 755)

Moreover, in the more recent case of *Bayan (Bagong Alyansang Makabayan), et al. v. Executive Secretary Zamora, et al.*[8], the Supreme Court elucidated:

"Section 21, Article VII deals with treaties or international agreements in general, in which case, the concurrence of at least two-thirds (2/3) of all the Members of the Senate is required to make the subject treaty, or international agreement, valid and binding on the part of the Philippines. This provision lays down the general rule on treaties or international agreements and applies to any form of treaty with a wide variety of subject matter, such as, but not limited to, extradition or tax treaties or those economic in nature. All treaties or international agreements entered into by the Philippines, regardless of subject matter, coverage, or particular designation or appellation, requires the concurrence of the Senate to be valid and effective."

The Supreme Court went as far as giving us the definition of a treaty, thus:[9]

"A treaty, as defined by the Vienna Convention on the Law of Treaties, is 'an international instrument concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments, and whatever its particular designation.' There are many other terms used for a treaty or international agreement, some of which are: act, protocol, agreement, *compromis d' arbitrage*, concordat, convention, declaration, exchange of notes, pact, statute, charter and *modus vivendi.* All writers, from Hugo Grotius onward, have pointed out that the names or titles of international agreements included under the general term treaty have little or no legal significance. Certain terms are useful, but they furnish little more than mere description.

"Article 2(2) of the Vienna Convention provides that 'the provisions of paragraph 1 regarding the use of terms in the present Convention are without prejudice to the use of those terms, or to the meanings which may be given to them in the internal law of the State.'

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[8] *342 SCRA 449 [2000]*
[9] *Ibid.*

"Thus, in international law, there is no difference between treaties and executive agreements in their binding effect upon states concerned, as long as the negotiating functionaries have remained within their powers. International law continues to make no distinction between treaties and executive agreements: they are equally binding obligations upon nations."

The Supreme Court, however, declared that concurrence of Congress is not necessary for an executive agreement to have binding effect. We quote:[10]

"In our jurisdiction, we have recognized the binding effect of executive agreements even without the concurrence of the Senate or Congress. In the case of ***Commissioner of Customs vs. Eastern Sea Trading***[11], we had the occasion to pronounce:

"xxx the right of the Executive to enter into binding agreements without the necessity of subsequent Congressional approval has been confirmed by long usage. From the earliest days of our history we have entered into executive agreements covering such subjects as commercial and consular relations, most-favored-nation rights, patent rights, trademark and copyright protection, postal and navigation arrangements and the settlement of claims. The validity of these has never been questioned by our courts.

xxx xxx xxx

"Furthermore, the United States Supreme Court has expressly recognized the validity and constitutionality of executive agreements entered into without Senate approval." (39 Columbia Law Review, pp. 753-754) (See, also, U.S. vs. Curtis-Wright Export Corporation, 299 U.S. 304, 81 L. ed. 255; U.S. vs. Belmont, 301 U.S. 324, 81 L. ed. 1134; U.S. vs. Pink, 315 U.S. 203, 86 L. ed. 796; Ozanic vs. U.S., 188 f. 2d. 288; Yale Law Journal, Vol. 15, pp. 1905-1906; California law Review, vol. 25, pp. 670-675; Hyde on International Law [Revised Edition] Vol. 2, pp. 1405, 1416-1418; Willoughby on the U.S. Constitutional Law, Vol. I [2d ed.], pp. 537-540; Moore, International Law Digest, Vol. V, pp. 390-407) (Emphasis supplied)' (Emphasis Ours)

[10] *Ibid.*
[11] No. L-14279, October 31, 1961

"The deliberations of the Constitutional Commission which drafted the 1987 Constitution is enlightening and highly –instructive:

> "MR. MAAMBONG. Of course it goes without saying that as far as ratification of the other state is concerned, that is entirely their concern under their own laws.
>
> "FR. BERNAS. Yes, but we will accept whatever they say. If they say that we have done everything to make it a treaty, then as far as we are concerned, we will accept it as a treaty.'

"The records reveal that the United States Government, through Ambassador Thomas C. Hubbard, has stated that the Untied States government has fully committed to living up to the terms of the VFA. For as long as the United States of America accepts or acknowledges the VFA as a treaty, and binds itself further to comply with its obligations under the treaty, there is indeed marked compliance with the mandate of the Constitution.

"Worth stressing too, is that the ratification, by the President, of the VFA and the concurrence of the Senate should be taken as a clear and unequivocal expression of our nation's consent to be bound by said treaty, with the concomitant duty to uphold the obligations and responsibilities embodied thereunder.

"Ratification is generally held to be an executive act, undertaken by the head of the state or of the government, as the case may be, through which the formal acceptance of the treaty is proclaimed. 43 A State may provide in its domestic legislation the process of ratification of a treaty. The consent of the State to be bound by a treaty is expressed by ratification when: (a) the treaty provides for such ratification, (b) it is otherwise established that the negotiating States agreed that ratification should be required, (c) the representative of the State has signed that treaty subject to ratification, or (d) the intention of the State to sign the treaty subject to ratification appears from the full powers of its representative, or was expressed during the negotiation.

"In our jurisdiction, the power to ratify is vested in the President and not, as commonly believed, in the legislature. The role of the Senate is limited only to giving or withholding its consent, or concurrence, to the ratification.

"With the ratification of the VFA, which is equivalent to final acceptance, and with the exchange of notes between the Philippines and the United States of America, it now becomes obligatory and incumbent on our part, under the principles of international law, to be bound by the terms of the agreement. Thus, no less than Section 2, Article II of the Constitution, declares that the Philippines adopts the generally accepted principles of international law as part of the law of the land and adheres to the policy of peace, equality, justice, freedom, cooperation and amity with all nations.

"As a member of the family of nations, the Philippines agrees to be bound by generally accepted rules for the conduct of its international relations. While the international obligation devolved upon the state and not upon any particular branch, institution, or individual member of its government, the Philippines is nonetheless responsible for violations committed by any branch pr subdivision of its government, Constitution and laws will carry out our international obligation. <u>Hence, we cannot readily plead the Constitution as a convenient excuse for non-compliance with out obligations, duties and responsibilities under international law</u>.

"Beyond this, Article 13 of the Declaration of Rights and Duties of States adopted by the International Law Commission in 1949 provides: 'Every State has the duty to carry out in good faith its obligations arising from treaties and other sources of international law, and it may not invoke provisions in its constitution or its laws as an excuse for failure to perform this duty.'

"Equally important is Article 26 of the Convention which provides that 'Every treaty in force is binding upon the parties to it and must be performed by them in good faith.' This is known as the principle of *pacta sunt servanda* which preserves the sanctity of treaties and have been one of the most fundamental principles of positive international law, supported by the jurisprudence of international tribunals."

One of the oldest and most fundamental rules of international law is expressed in the maxim, *pacta sunt servanda*, that a treaty must be performed in good faith.[12]

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[12] *Philippine Law Dictionary, Third Edition, p. 668, citing Bawden Drilling International Ltd. v. South Eastern Sierra Madre Resources Inc., 56861-R, January 19, 1978.*

The Philippine Government is bound by the terms and conditions in the Exchange of Notes and has the obligation to respect and observe the stipulations agreed upon. The BIR, as one of the agencies attached to the Executive Department of the Government, cannot argue against effecting the terms of an executive agreement.

Pursuant to Section 32(B)(5) of the 1997 Tax Code, income of any kind to the extent required by any treaty obligation binding upon the Government of the Philippines is exempt from taxation.

As previously discussed, and in the absence of a definition in the Tax Code, "treaty" embraces all sorts of international agreements regardless of whatever terminology or nomenclature used. Contrary to the view of the majority, Section 32 (B) of the Tax Code is applicable in this case as the Exchange of Notes which is considered a treaty in international law, created an obligation on the part of the Philippine Government to exempt the Fund used for the Project.

As obiter, such provision is not all encompassing to exclude other forms of tax exemptions which our Government may grant. A statute cannot deprive any branch of the Government of its constitutional powers.

Moreover, while BIR Ruling No. DA-407-98 dated September 7, 1998 declared that the Exchange of Notes does not grant tax exemption but only assumption of tax obligations, the Court is not bound to rule in the same manner. BIR rulings, although entitled to great respect, are not conclusive and necessarily do not bind the Court.[13]

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[13] *Philippine Bank Communications vs. Commissioner of Internal Revenue, 302 SCRA 241 [1999]*

I object to the majority's view that the remedy available to the respondent is already provided in Revenue Memorandum Circular No. 42-99 dated June 2, 1999.

As correctly held by the Court's Division, and I quote:

> "Likewise, this court is aware of Revenue Memorandum Circular (RMC) No. 42-99, dated June 2, 1999, amending Revenue Memorandum Circular No. 32-99, which has for its subject the standard clauses (referring to Item 5 paragraphs 1 and 2 of said Exchange of Notes) pertaining to the tax treatment of participating Japanese contractors and nationals under the exchange of notes between the Japanese Government and the Republic of the Philippines, providing for the proper procedure for petitioner in case where it already paid the taxes subject of this case to the BIR.
>
> xxx xxx xxx
>
> Indubitably, under the RMC as regards income taxes, petitioner is only required to file its ITR but need not pay the taxes due thereunder. The commissioner of the BIR has mandated the District Officer to collect the income taxes from the government executing agency. But in cases where income taxes were previously paid directly by petitioner to the BIR, as what petitioner did in this case, the cash refund shall be recovered from the NPC. However, the RMC *(sic)* dated June 2, 1999 only took effect after its publication in the National Administrative Register, July-September 1999 issue while the ITR of petitioner was filed on July 15, 1998 or almost a year before the issuance of the RMC. Therefore, we hold that said refund must be claimed directly by petitioner from the respondent for it would be unfair on the part of the petitioner that said RMC be given retroactive effect.

Moreover, memorandum circulars are issued in relation to internal administration of an agency[14]. They are not laws that everyone must observe and follow.

It cannot be said that RMC 42-99 is controlling than Section 229 of the NIRC, which provides that tax erroneously or illegally collected should be filed with the Commissioner of Internal Revenue. Courts will not countenance administrative

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[14] *Please see Section 6, Chapter 2, Book III of the Revised Administrative Code of 1987*

issuances that override instead of remaining consistent and in harmony with, the law they seek to apply and implement.[15]

The case of ***Commissioner of Internal Revenue vs. Mitsubishi Metal Corporation***[16] has no bearing in the instant case. In the said case, Atlas Consolidated Mining and Development Corporation entered into a Loan and Sales Contract with Mitsubishi Metal Corporation, a Japanese corporation licensed to engage in business in the Philippines, for purposes of the projected expansion of the productive capacity of the former's mines in Toledo, Cebu. Under said contract, Mitsubishi agreed to extend a loan to Atlas in the amount of $20,000,000.00, United States currency, for the installation of a new concentrator for copper production. Atlas, in turn, undertook to sell to Mitsubishi all the copper concentrates produced from said machine for a period of fifteen (15) years. It was contemplated that $9,000,000.00 of said loan was to be used for the purchase of the concentrator machinery from Japan.

Obviously, the aforementioned case involves a contract entered into by private parties which is not so in this case. As mentioned earlier, this case involves an exchange of notes between two governments, wherein the principles of international law should be properly applied. Article II Section 2 of the 1987 Constitution has expressly adopted the generally accepted principles of international law as part of the law of the land. International comity relates to rules of international courtesy, etiquette, or good-will which are in fact, or which ought to be, observed by states in their mutual relations. It may manifest itself in various forms such as the practice of diplomatic protocol and extradition even in the absence of a

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[15] Commissioner of Internal Revenue vs. Court of Appeals, 240 SCRA 368 [1993]
[16] *G.R. No. 54908, January 22, 1990, 181 SCRA 82*

definitive treaty on the matter.[17] "xxx Under international comity, a state must recognize the generally accepted tenets of international law, among which are the principles of sovereign equality among states and of their freedom from suit without their consent, that limit the authority of a government to effectively impose taxes on a sovereign state and its instrumentalities, as well as on its property held, and activities undertaken, in that capacity. xxx"[18]

In fine, to hold that respondent is mandated to pay for taxes relative to the OECF-funded portion of the Calaca II Project will result in a violation of the provisions in the Exchange of Notes. The Court must not only consider our present Constitution and tax laws, but the impact of the decision to be rendered on our relations with Japan and the Japanese firms and nationals for they work as our allies in promoting the economic development efforts of our Government.

"It must be remembered that "tax exemption is founded on public policy ... are granted on the ground that they will benefit the public generally, or as a reward or compensation for services rendered in the performance of some function deemed socially desirable ... are favored on the theory that the concession is due to *quid pro quo* for the performance of services essentially public by which the State is relieved *pro tanto* from performing" (84 C.J.S. No. 215, pp.413-414)."[19]

In view thereof, the income and branch profit remittance taxes paid by herein respondent when such payments should have been made by the NPC, constitute erroneous payment of taxes which fall within the purview of Section 229 of the 1997 National Internal Revenue Code.

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[17] *Paras, International Law and World Organizations, 1980 ed., pp. 26-27.*
[18] *Vitug and Acosta, Tax Law and Jurisprudence, 2nd ed., p. 11*
[19] *P & N Corporation (Manila Branch Office) vs. Commissioner of Internal Revenue, CTA Case Nos. 4163 & 4293, July 24, 1991)*

Accordingly, I vote to grant the claim for refund of Mitsubishi Corporation-Manila Branch.

LOVELL R. BAUTISTA
Associate Justice

I CONCUR:

ERNESTO D. ACOSTA
Presiding Justice