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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

P & N CORPORATION (MANILA BRANCH OFFICE),
Petitioner,

- versus - C.T.A. CASE NOS. 4163
4293

COMMISSIONER OF INTERNAL REVENUE,
Respondent.
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7/24/91

D E C I S I O N

These consolidated cases involve claims for refund of allegedly erroneously collected contractor's and withholding taxes.

Petitioner is a Japanese corporation duly licensed to do business in the Philipines. On January 11, 1985, it entered into a contract with the Philippine Government for the supply, installation, commissioning, testing and maintenance of a Traffic Control System and associated works in Metro Manila designated as Contract No. PL-TCC (85)-1. For the work performed during the periods from June 1, 1985 to March 31, 1986 (CTA Case No. 4163), and October 1986 to March 1988 (CTA Case No. 4293), the Government through the Ministry of Public Works and Highways, deducted and withheld from petitioner's accomplishment billings contractor's and withholding taxes in the amounts of P940,299.70 and P943,663.78 respectively for each period totaling P1,883,963.48 and paid the same to the Bureau of Internal Revenue, Petitioner now seeks the recovery of said amounts on the ground that it is exempted from payment thereof.

Petitioner filed a claim for refund on October 14, 1988 for CTA Case No. 4163, and on August 2, 1988 for CTA Case No. 4293. Respondent failed to act on said claims hence the Petitions for Review were filed on June 18, 1987 and September 6, 1988 for CTA Cases Nos. 4163 and 4293 respectively.

Petitioner bases its claim of exemption from contractor's and income tax on Article 17 of its contract, an Exchange of Notes between the Japanese and Philippine governments dated June 9, 1981, and BIR Ruling No. 138-88 dated April 14, 1988. Pertinent portions of the BIR Ruling, which likewise reproduces the provisions of the Contract and Exchange of Notes involved herein, is reproduced below:

April 14, 1988

Carpio, Villaraza and Cruz Law Offices
5th Floor, LTA Bldg., 1189 Peres St.,
Legaspi Village, Makati, Metro Manila

Attn: Atty. Antonio Tirol Carpio

Gentlemen:

This refers to your letter dated March 1, 1988 requesting confirmation of your opinion to the effect that your client, P & N Corporation and its personnel are exempt from Philippine taxes in connection with the filing of corporate and individual income tax returns on income derived from the project.

It is represented that your client is the prime contractor of the Establishment of Floor Forecasting and Warning System for Dam Operation Project and the Supply, Installation, Commissioning, Testing And Maintenance of the Traffic Control System and Associated Works in Metro Manila Phase II Project under PL-PAGASA (84)-1 and PL-TCC(85)-1 respectively, entered into between your client and the Government of the Republic of the Philippines; and that both projects are funded by the Exchange of Notes between the Philippine Government and the Japanese Government.

In reply thereto, I have the honor to inform you that pursuant to paragraph 5(2) of the Exchange of Notes dated June 9, 1981 between the Philippine Government and the Japanese Government and Article 14 of Contract PL-PAGASA (84)-1 Loan Agreement No. PJ-P53 as well as Article 17 of contract PL-TCC(85)-1 Loan Agreement No. PH-P54 of pertinent portions of which are quoted hereunder as follows:

"5. (1) xxx

"(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 <u>on and/or in connection with any income that may accrue from the supply of products and/or services to be provided under the Loan.</u>" (Emphasis supplied)

"ARTICLE 14

xxx

<u>ARTICLE 17. TAXES AND OTHER CHARGES AND LICENSES</u>

17.1 xxx

17.2 The CONTRACTOR shall be exempted from customs duties and other import taxes on the Goods, and on CONTRACTOR'S vehicles, supplies and equipment which will be imported into the Philippines solely for the purpose of carrying out the contract. The Goods shall include those to be brought in the Philippines for replacement and/or repair of defective parts covering the entire period stated in Article 5.

17.3 <u>The CONTRACTOR and members of its staff who are not citizens of the Philippines shall be exempted from all fiscal levies or taxes imposed in the Republic of the</u>

Philippines in respect to all the Work carried out in the Philippines in connection with this Contract, including the following taxes and duties:

17.3.1 Personal and income and business taxes;

17.3.2 Corporate income and business taxes nationals or local including fees or any charges imposed by the national and local government;

17.3.3 Sales Tax;

17.3.4 The CONTRACTOR'S tax and municipality taxes;

17.3.5 Stamp duty for the Contract;

17.3.6 Import taxes and duties for personal effects.

Japanese contractor and their foreign personnel are exempt from Philippine taxes. Such being the case, P & N Corporation of Japan which is undertaking OECF-assisted projects in the Philippines is exempt from the corporate income tax imposed under Section 25(e) (1) of the Tax Code, as amended, on resident foreign corporations engaged in trade or business within the Philippines; from the 10% value-added tax on its imported equipment as well as for its sale of services relative to the aforementioned projects pursuant to Sections 101 and 102 of the Tax Code, as amended. Moreover, its foreign personnel shall also be exempt

> from the individual income tax prescribed under Section 22 of the same Code, as amended. Finally, P & N Corporation is not required to file quarterly income tax returns and final or adjustment returns on income derived from the aforesaid project. Likewise, its foreign personnel are not also required to file individual income tax returns on income also derived from the said project.
>
> Very Truly yours,
>
> BIENVENIDO A. TAN JR.
> Commissioner of Internal Revenue

Respondent contends that the petitioner has failed to show any statute, legislative grant or treaty binding on the Philippine Government expressly exempting it from income tax and contractor's tax; that the Exchange Notes and the Contract can not be considered the law creating petitioner's right to be exempted from Philippine taxes; and, although respondent issued the BIR ruling to the effect that petitioner and its foreign personnel are exempt from Philippine taxes, the same does not bind the government because said opinion contravenes the well settled doctrine that one who claims to be exempt from payment of a particular tax must do so under clear and unmistakable terms found in a statute.

Petitioner, in reply thereto alleges that the 1973 Constitution, which was in effect when the

Exchange of Notes and the Contract was executed, allows the President to enter into international agreements, that an exchange of notes is an executive agreement, and thus, having been validly entered into by the president, it is binding on the Philippine Government and partakes of the nature of the law; and that having already issued a ruling on this matter, respondent can not take a position inconsistent with one previously taken.

Respondent's contention that petitioner has failed to show any statute, legislative grant or treaty binding on the Philippine government, expressly exempting petitioner from income taxes and contractor's tax is unavailing. The Exchange of Notes in this case is the source of petitioner's right to the exemption. An Exchange of Notes is defined as:

> "... an informal method whereby states subscribed to certain understandings or recognize certain obligations as binding upon them." **(Salonga & Yap, Public International Law** [4th Ed.] p. 304).

> "... an interchange of diplomatic notes between a diplomatic representative and the Ministry of Foreign Affairs of the Senate to which he is accredited. Not infrequently, agreements are concluded between States by means of such exchange of notes." (Coquia & Defensor-Santiago, **Public International Law.** (1984), p. 584).

And this kind of correspondence is included under the general term "Executive Agreements". As petitioner cited:

> "On the basis of American practice, executive agreements may be classified into two groups: (1) agreements made purely as executive acts affecting external relations and independent of legislative authorizations, (2) and agreements entered into in pursuance of acts of Congress. The first class of executive agreements may cover a multitude of subjects affecting primarily external relations. They are often used in establishing a modus vivendi with other governments or in the settlement of pecuniary claims of citizens against foreign countries for violation of rights protected by treaties or by rules of international law. Sometimes they are made to supply the details necessary for the execution of treaties previosly entered into or to furnish a guide for their interpretation. They need not conform with the national policies declared by Congress unless they involve constitutional right of the individuals within the country. They may take the form of protocols, exchange of notes, or other types of documents and are often temporary in character." (**Sinco, Philippine Political Law** [1962], p. 296).

According to **Coquia & Defensor-Santiago,** (supra. p. 595) "Due to an expansion of intercourse among states especially in the economic and technical fields, States now use less formal types of international agreements, such as executive agreements of exchange of notes, usually intended to be binding upon signature alone." And, "from the point of view of international law, there is no difference between treaties and executive agreements in their binding effect upon the states concerned" (**Sinco**, supra., p. 297). Thus the exchange of notes, being an executive agreement, binds the government and thus partakes of the nature of law.

In **USAFFE Veterans Association, Inc. vs. The Treasurer of the Philippines, et al.**, (105 Phil. 1030, June 30, 1959), the Supreme Court apparently held that executive agreements may be entered into with other states, and are effective without legislative concurrence. Likewise in **Commissioner of Internal Revenue vs. John Gotamco & Sons, Inc.** (148 SCRA 36, February 27, 1987), the Supreme Court upheld the entitlement of the World Health Organization to tax exemption under the Host Agreement entered into by the Philippines with WHO despite the fact that said agreement was likewise not submitted to the Senate for ratification. The Court held therein that "[W]hile treaties are required to be ratified by the Senate under the Constitution, less formal types of international agreements may be entered into by the Chief

Executive and become binding without the concurrence of the legislative body." The Military Bases agreement, for one, grants tax exemptions although it is purely an executive agreement.

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 perf[illegible]g" (84 C.J.S. No. 215, pp. 413-414). Thus it is important to note that the exchange of notes in this case was entered into in pursuance of a loan agreement with Japan. Under the Constitution, in force at that time, the President may contract and guarantee foreign and domestic loans on behalf of the Republic of the Philippines subject to such limitations as may be provided by law (**Art. II, Sec. 12, 1973 Constitution**, as amended). Therefore having validly entered into a loan agreement through the exchange of notes, the terms therein necessarily governs the execution of the loan agreement. The contract, involved in this case which was entered into pursuant to the loan merely embodied the exemption provision in said exchange of notes.

The BIR Ruling dated April 14, 1988 further buttress petitioner's claim for refund. The law presumes that official duty has been performed and therefore, before issuing said ruling, the respondent is considered to have gone over the laws applicable and found that petitioner is indeed entitled to tax exemptions. If respondent thinks petitioner is not in fact entitled to the exemptions, he could have had the ruling revoked. The respodent neither assailed the validity of the ruling nor sought its revocation in these petitions. Instead, he merely stated that he is not bound thereby because it will allegedly contravene the principle that a tax exemption must have a basis in statute. As already discussed, statutes are not the exclusive repository of tax exemptions. Contracts and treaties have likewise been constant sources of tax exemptions. A mere allegation in the pleading that the respondent can not be bound by said ruling for being contrary to law would be taking an incosistent position to the prejudice of the petitioner. Thus, not having been validly revoked, the ruling remains in force and effect.

As to petitioner's prayer for interest, the same is denied following the well settled doctrine that Government can not be made to pay interest on an amount deemed to be refundable in the absence of a statutory provision expressly authorizinr such payment of interest and in the absence of arbitrariness in the collection of the tax. The prayer for costs of suit is likewise denied for the same can not be imposed on the Government.

WHEREFORE, petition is granted. Respondent Commissioner of Internal Revenue is ordered to refund to petitioner the total sum of P1,883,963.48 representing erroneously collected contractor's and withholding taxes.

No pronouncement as to cost.

SO ORDERED.

Quezon City, Metro Manila, July 24, 1991.

CONSTANTE C. ROAQUIN
Associate Judge

WE CONCUR:

ALEX Z. REYES
Presiding Judge

ERNESTO D. ACOSTA
Associate Judge

C E R T I F I C A T I O N

I hereby certify that this 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.

ALEX Z. REYES
Presiding Judge
Court of Tax Appeals