REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE, Petitioner,	C.T.A. EB No. 1041 (C.T.A. CASE No. 8188)
	Present:
- versus -	DEL ROSARIO, *PJ* CASTAÑEDA, JR. BAUTISTA, UY, CASANOVA, FABON-VICTORINO, MINDARO-GRULLA, COTANGCO-MANALASTAS, *and* RINGPIS-LIBAN, *JJ.*
	Promulgated:
GOODYEAR PHILIPPINES, INC., Respondent.	AUG 14 2014 9:05 a.m.

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DECISION

***Fabon-Victorino, J.*:**

In this Petition for Review, the Commissioner of Internal Revenue (CIR), assails the Decision dated March 25, 2013 and the Resolution dated June 26, 2013, both rendered by the Court in Division granting respondent Goodyear Philippines, Inc.'s claim for refund of erroneously withheld and remitted Final Withholding Tax (FWT) in the amount of P14,659,847.10.

The following facts as found by the Court in Division remain undisputed.

Petitioner is the Commissioner of the Bureau of Internal Revenue (BIR), with the authority to refund overpaid or erroneously collected internal revenue taxes. She holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

Respondent Goodyear Philippines, Inc., on the other hand, is a Philippine corporation registered with the Securities and Exchange Commission (SEC), with address at Alabang-Zapote Road, Barangay Almanza, Las Piñas City. It is a registered large taxpayer with Identification Number (TIN) 000-409-561-000 issued by the BIR.

On August 19, 2003, the SEC approved respondent's application for increase in its authorized capital stock from P400,000,000.00, divided into 4,000,000 shares with par value of P100.00 each, to P1,731,863,000.00, divided into 4,000,000 common shares and 13,318,630 preferred shares with par value of P100.00 each.

Respondent's 13,318,630 preferred shares with an aggregate par value of P1,331,863,000.00 were solely and exclusively subscribed by Goodyear Tire and Rubber Company (GTRC), a foreign company organized and existing under the laws of the State of Ohio, United States of America (USA), with principal office at 1144 East Market Street, Akron, Ohio, USA. It is not registered as a corporation or partnership in the Philippines.

In a regular meeting held on May 30, 2008, respondent's Board of Directors authorized the redemption on October 15, 2008 of the 3,729,216 preferred shares issued to GTRC at the redemption price equivalent to P100.00 per share and the amount of dividends accrued and unpaid at the date of redemption payable on November 15, 2008.

The total payment at redemption amounted to P470,653,914.00, broken down as follows:

w/

Aggregate Par Value (P100.00 per share x 3,729,216 shares)	P372,921,600.00
Accrued and unpaid dividends	97,732,314.00
Redemption Price	**P470,653,914.00**

On October 15, 2008 or thirty-one (31) days before the scheduled payment of the redemption price to GTRC on November 15, 2008, respondent and GTRC jointly filed an Application for Relief from Double Taxation (BIR Form No. 1928) with the International Tax Affairs Division (ITAD) of the BIR, requesting the confirmation of tax exemption on redemption by respondent of its 3,729,216 preferred shares subscribed by GTRC in accordance with the Republic of the Philippines-United States of America (RP-US) Tax Treaty.

This notwithstanding and taking a conservative position, respondent, on November 3, 2008, withheld and remitted to the BIR the amount of P14,659,847.10, representing the 15% Final Withholding Tax (FWT) imposed under Section 28(B)(5)(b) of the National Internal Revenue Code (NIRC) of 1997, as amended, computed on the basis of the difference between the redemption price and the aggregate par value of the shares redeemed, to wit:

Redemption Price	P470,653,914.00
Par Value/Cost of Acquisition (P100.00 per share x 3,729,216 shares)	P372,921,600.00
Difference	97,732,314.00
Multiplied with 15% FWT rate	**P14,659,847.10**

The BIR ITAD failed to act on respondent's request for confirmation on its tax exemption by virtue of the Tax Treaty.

In view thereof, respondent filed with the BIR Large Taxpayers Audit and Investigation Division (LTAID) an application for refund in the amount of P14,659,847.10 on October 21, 2010.

Barely 13 days thereafter, or on November 3, 2010, respondent elevated the matter to the Court in Division via a

Petition for Review alleging inaction of petitioner on its administrative claim for refund.

In her Answer, petitioner zeroed in on the defense that respondent was not entitled to the refund sought having failed to submit complete supporting documents at the administrative level and prematurely filed the Petition for Review depriving the Court in Division of jurisdiction to entertain the same. Besides, the burden lies on respondent to prove entitlement to the refund sought since tax refunds are akin to tax exemptions which must be strictly construed against the claimant.

After the parties rested their respective cases, the Court in Division promulgated the assailed Decision in favor of respondent on March 25, 2013, the dispositive portion of which reads as follows:

> WHEREFORE, premises considered, the Petition for Review is hereby GRANTED. Accordingly, the Commissioner of Internal Revenue is hereby ORDERED to REFUND or to ISSUE A TAX CREDIT CERTIFICATE in the amount of P14,659,847.10 to Goodyear Philippines, Inc., representing erroneously withheld and remitted Final Withholding Tax.
>
> SO ORDERED.

In the Resolution dated June 26, 2013, the Court in Division denied petitioner's Motion for Reconsideration for lack of merit.

Hence, this appeal before the Court *En Banc* on the following grounds:

> A. RESPONDENT COMMITTED A FATAL ERROR WHEN IT FAILED TO SUBMIT THE SUPPORTING DOCUMENTS

NECESSARY TO SUBSTANTIATE ITS ADMINISTRATIVE CLAIM FOR TAX REFUND;

i. SUCH FAILURE RENDERED RESPONDENT AS TO HAVE NOT THOROUGHLY APPLIED THE ADMINISTRATIVE REMEDY WHICH WAS AVAILABLE TO IT;

ii. RESPONDENT'S FAILURE TO EXHAUST ITS ADMINISTRATIVE REMEDIES RENDERS THIS HONORABLE COURT WITHOUT JURISDICTION OVER THIS PARTICULAR CLAIM;

B. RESPONDENT'S CLAIM FOR TAX REFUND, WHICH IS CONSIDERED AS A CATEGORY OF TAX EXEMPTION, MUST BE JUSTIFIED BY THE CLEAREST GRANT OF LAW;

C. THE REDEMPTION PREMIUM THEORY ESPOUSED BY RESPONDENT ALLOWS IT TO BYPASS THE PAYMENT OF THE PROPER TAX;

D. RESPONDENT'S PAYMENT OF THE DIVIDENDS IN ARREARS WAS NOT PREDICATED UPON THE ACT OF REDEMPTION, AND THE AMOUNT IT PAID IN SETTLEMENT THEREOF DID NOT FORM PART OF THE REDEMPTION PRICE; and

E. RESPONDENT'S LONE PREFERRED SHAREHOLDER WHO HAD ITS SHARES REDEEMED INCURRED AN INCOME SINCE THE REDEMPTION PRICE IT RECEIVED EXCEEDED THE PAID-IN EQUITY IT HAD INITIALLY PUT INTO RESPONDENT'S BUSINESS.

In this appeal, petitioner reiterates that due to respondent's inability to submit complete documents at the administrative level it failed to exhaust administrative remedies, rendering the filing of its Petition for Review premature thereby depriving the Court in Division of jurisdiction to entertain the same. Petitioner complains that only before the Court in Division that respondent presented evidence for its alleged entitlement to refund. By going to the Court in rapid haste barely 13 days after the administrative claim for refund was lodged with her office, she was effectively prevented from acting on the claim for refund at her level within the period allowed by law.

Further, a claim for tax refund is akin to a claim for tax exemption which must be construed *strictissimi juris* against the claimant, the herein respondent.

While petitioner acknowledges that respondent's redemption and payment of subscription price is not subject to income tax, she insists that the additional amount in excess of the original subscription price paid by respondent to GTRC 31 days after redemption date should not be treated as a mere premium, hence, part of the subscription price as perceived by respondent, but as accumulated dividends in arrears of the redeemed preferred shares, hence, subject to 15% final withholding tax on dividends.

Allegedly, even if no redemption occurred, respondent would still pay the same amount annually to GTRC as inevitable consequence of the latter's subscription of respondent's preferred shares. In any event, respondent was only the withholding agent for the ultimate tax liability was on GTRC, who realized income or revenue when respondent redeemed its preferred shares. Having realized such income or revenue, the same was subject to tax, which respondent was legally bound to withhold.

In rejecting the foregoing protestation, respondent argues that contrary to petitioner's claim, the Court in Division acquired jurisdiction over its Petition for Review. Firstly, it was able to submit complete documents in support of its administrative claim for refund. Secondly, the determination of documents for submission in the administrative level lies on the taxpayer-claimant and not on respondent or the BIR lest the latter can require documents which the taxpayer cannot possibly submit thereby indirectly and effectively negating the right to claim such refund.

Respondent admits that it sought judicial intervention barely 13 days after it lodged its administrative claim for refund to preserve its right to refund the erroneously paid tax since the 2-year prescriptive period to claim for refund mandated under Section 229 of the NIRC was about to lapse.

In any event, any gain that may have resulted from the subscription of the preferred shares of stock by GTRC are not taxable in the Philippines pursuant to paragraph 2 of Article 14 (Capital Gains) and Article 1 of the Reservation Clause of the RP-US Tax Treaty.

Moreover, under the RP-US Tax Treaty, the definition of what constitutes dividend income is determined by the law of the State of which the corporation making the distribution is a resident. Since respondent is a resident of the Philippines, the subject redemption is governed by the relevant provisions of the NIRC, as amended. Pursuant to Section 73(A) of the NIRC, the additional amount paid by respondent is deemed capital gain of GTRC since the said gain cannot be treated as dividend for it is not a recurring return of stock. Further, Section 73(B) of the same Code, which provides that only in cases of redemption of shares previously issued as stock dividends that the difference between the par value of the shares and the redemption price may be treated as taxable dividend, is not applicable as there was no unrestricted retained earnings or profits to distribute. To rule that said difference should be considered as dividends is to contravene Section 43 of the Corporation Code which provides that a corporation may only declare dividends out of unrestricted retained earnings.

Respondent also gives premium to the favorable finding of the Court in Division that it was able to establish the erroneous withholding and remittance to the BIR of the 15% FWT arising from the redemption of the subject preferred shares subscribed by GTRC and that such erroneously withheld amount were not utilized as tax credit by GTRC, hence, respondent is entitled to the refund sought.

Respondent does not agree with petitioner that the amount over and above the subscription price it paid to GTRC are actually the dividends that have accrued under GTRC's subscription, thus, subject to FWT. The said amount, according to respondent, should be deemed as capital gains by virtue of petitioner's own issuance, namely, RR No. 006-08. The said additional price should not be considered and taxed as accumulated dividends as it was not paid out of respondent's unrestricted retained earnings. Besides, respondent could not have legally declared and paid dividends for the years 2003 to 2009 since it did not have unrestricted retained earnings having been in deficit for the said years as indicated in its Audited Financial Statements (AFS).

The petition lacks merit, hence, should be denied.

Perusal of the grounds raised by petitioner reveals that they are mere restatements of her previous arguments which were categorically rejected by the Court in Division in the assailed Decision of March 25, 2013. But if only to put petitioner's mind at rest, the Court *En Banc* will discuss the salient points upon which the conclusion of the Court in Division was anchored.

From the evidence presented, both the administrative and the judicial claims for refund of the 15% FWT in the amount of P14,659,847.10 were timely filed by respondent on October 21, 2010 and November 3, 2010, respectively, or within two (2) years from the date of payment of the tax on November 3, 2008, in accordance with the clear mandate of Section 229 of NIRC of 1997, as amended, which states:

> SECTION 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 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, 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: Provided, however, That the Commissioner may, even without a written claim therefor, refund or credit any tax, where on the face of the return upon which payment was made, such payment appears clearly to have been erroneously paid.

As to the contention that the Court in Division was stripped of competence to entertain the Petition for Review due to respondent's failure to exhaust administrative remedies on account of its inability to submit complete documents in the administrative level, suffice it to say that the prerogative to determine what relevant documents to submit in support of an administrative claim for refund belongs to the taxpayer-claimant. Petitioner cannot lay claim to such right for otherwise, a taxpayer-claimant such as respondent will be at her mercy should she require the production of documents that a taxpayer cannot submit."[1]

Note that the non-submission of complete documents in the administrative level is not fatal to a judicial claim for refund provided that the taxpayer-claimant is able to adduce sufficient evidence before the Court in support of its judicial claim for refund. It must be stressed that the CTA is a court of record and cases filed before it are litigated *de novo,* as what occurred in the instant case. All party litigants must prove every minute aspect of their cases that will justify the grant of refund (CIR v. Manila Mining Corporation, G.R. No. 153204, August 31, 2005).

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[1] Commissioner of Internal Revenue vs. First Express Pawnshop, G.R. Nos. 172045-46, June 16, 2009.

In addition, there is nothing in the record indicating that petitioner required respondent to submit additional evidence or specific relevant documents that would aid her assess the merit of respondent's claim for refund. The Supreme Court unfolded its mind on the matter and went on to say:

> The Court cannot simply accept the allegation of the CIR that Metrobank failed to submit the relevant supporting documents within 60 days from the filing of its protest on 17 January 2003, when the CIR does not even identify what these documents are. If the Court does not know what particular documents Metrobank purportedly failed to submit in support of its protest, then the Court likewise cannot make a determination on the relevance of such documents. In addition, there appear to be sufficient documents submitted by Metrobank to the CIR to have enabled the latter to render on 2 March 2004 a Decision on the protest of the former.[2]

The allegation that by sprinting to the Court barely 13 days after the administrative claim for refund was lodged with her office, respondent deprived her of the opportunity to act at her level also lacks merit. Section 229 of the NIRC, as amended is clear. A taxpayer must file both its administrative and judicial claims for refund within two years after payment of the taxes erroneously received by the BIR,[3] otherwise the right to appeal to this Court would be forfeited. Well-settled is the rule that when the said two-year period is about to prescribe and the claim for refund with respondent has not been acted upon, for the protection of the interest of the taxpayer, he should file a petition for review with the CTA within the said two-year period; otherwise, if the decision of respondent is adverse and it was made after the two-year period, he can no longer appeal the same to the

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[2] Metropolitan Bank and Trust Co. vs. Commissioner of Internal Revenue, G.R. No. 178797, August 04, 2009.

[3] Philam Asset Management, Inc. vs. Commissioner of Internal Revenue, G.R. NOS. 156637/162004, December 14, 2005.

CTA.[4] The Supreme Court has consistently and repeatedly held that the claim for refund with the BIR and the subsequent appeal to the CTA must be filed within the two-year prescriptive period. "If, however, the (BIR) Collector takes time in deciding the claim, and the period of two years is about to end, the suit or proceeding must be started in the Court of Tax Appeals before the end of the two-year period without awaiting the decision of the (BIR) Collector."[5]

In the instant case, respondent had no option but to seek judicial intervention in its claim for refund 13 days after its administrative recourse was filed so as not to forfeit its right to appeal to the CTA.

Finally, on the tax treatment of the additional price on top of the subscription price paid by the respondent to GTRC, nothing is clearer than the exhaustive discussion made by the Court in Division in the assailed Decision of March 25, 2013, leaving no stone unturned in this wise:

> The issue now is whether the redemption of 3,729,216 preferred shares issued to GTRC is subject to Philippine income tax on the difference between the Redemption Price and GTRC's total cost of acquisition of the shares redeemed (which is also equivalent to their aggregate par value), computed as follows:

Redemption Price	P470,653,914.00
Aggregate Par Value/Total Cost of Acquisition (P100.00 per share x 3,729,216 shares)	372,921,600.00
Difference	97,732,314.00
15% FWT	**P14,659,847.10**

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[4] Commissioner of Internal Revenue vs. Hitachi Computed Products (Asia) Corporation, CA-G.R. SP No. 63340, February 7, 2002 citing Gibbs vs. Collector of Internal Revenue and Court of Tax Appeals, 107 Phil 232, Johnson Lumber Co. vs. CTA, 101 Phil 151.

[5] Commissioner of Internal Revenue vs. Victorias Milling Co., Inc., and The Court Of Tax Appeals, G.R. No. L-24108, January 3, 1968.

Redemption is repurchase, a reacquisition of stock by a corporation which issued the stock in exchange for property, whether or not the acquired stock is cancelled, retired or held in the treasury.

In Revenue Regulations (RR) No. 006-0860 dated April 22, 2008, the BIR consolidated the rules on the taxation of shares redeemed for cancellation or retirement or when the same are treated as treasury shares, to wit:

> SECTION 9. Taxation of Shares Redeemed for Cancellation or Retirement. - When preferred shares are redeemed at a time when the issuing corporation is still in its 'going-concern' and is not contemplating in dissolving or liquidating its assets and liabilities, **capital gain or capital loss upon redemption shall be recognized on the basis of the difference between the amount/value received at the time of redemption and the cost of the preferred shares**.
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> Similarly, the capital gain or loss derived shall be subject to the regular income tax rates imposed under the Tax Code, as amended, on individual taxpayers or to the corporate income tax rate, in case of corporations.
>
> **This section, however, does not cover situations where a corporation voluntarily buys back its own shares, in which it becomes treasury shares**. In such cases,

> the stock transaction tax under Sec. 127 (A) of the Tax Code shall apply if the shares are listed and executed through the trading system and/or facilities of the Local Stock Exchange. Otherwise, **if the shares are not listed and traded through the Local Stock Exchange, it is subject to the 5% and 10% net capital gains tax**.' (Emphasis supplied)

Hence, in general, when preferred shares are redeemed and classified as treasury shares in the books of the issuing corporation, pursuant to RR No. 006-08, the net capital gain derived from the redemption of the preferred shares is generally subject to the 5% and 10% capital gains tax. In the case of a nonresident foreign corporation, the net capital gain shall generally be subject to the capital gains tax imposed under Section 28(B)(5)(c) of the NIRC of 1997, as amended, which is quoted hereunder:

> SEC. 28. *Rates of Income Tax on Foreign Corporations.-*
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> (B) *Tax on Nonresident Foreign Corporation. -*
>
> (1) *In General*. - Except as otherwise provided in this Code, a foreign corporation not engaged in trade or business in the Philippines shall pay a tax equal to thirty-five percent (35%) of the gross income received during each taxable year from all sources within the Philippines, such as interests,

> dividends, rents, royalties, salaries, premiums (except reinsurance premiums), annuities, emoluments or other fixed or determinable annual, periodic or casual gains, profits and income and capital gains, **except capital gains subject to tax under subparagraphs 5(C)**: *Provided*, That effective January 1, 2009, the rate of income tax shall be thirty percent (30%).
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> x x x x x x x x x
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> (5) *Tax on Certain Incomes Received by a Nonresident Foreign Corporation.*
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> x x x x x x x x x
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> (c) *Capital Gains from Sale of Shares of Stock not Traded in the Stock Exchange*. - **A final tax at the rates prescribed below is hereby imposed upon the net capital gains realized during the taxable year from the sale, barter, exchange or other disposition of shares of stock in a domestic corporation,** except shares sold, or disposed of through the stock exchange:
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> Not over P100,000. . . . . 5%
>
> On any amount in excess of P100,000 . . 10%" (Emphasis supplied)

However, in the instant case, since GTRC is a resident of the US, the provisions of the RP-US Tax Treaty shall also apply in determining the Philippine income taxation of the net capital gain that GTRC derived on the redemption by (respondent) of its 3,729,216 preferred shares, which were reclassified as treasury shares in the books of (respondent).

Article 14 of the RP-US Tax Treaty provides as follow:

Article 14
CAPITAL GAINS

(1) Gains from the alienation of tangible personal (movable) property forming part of the business property of a permanent establishment which a resident of a Contracting State has in the other Contracting State or of tangible personal (movable) property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such a fixed base, may be taxed in the other State. However, gains derived by a resident of a Contracting State from the alienation of ships, aircraft or containers operated by such resident in international traffic shall be taxable only in that State, and gains described in Article 13 (Royalties) shall be taxable only in accordance with the provisions of Article 13.

(2) **Gains from the alienation of any property other than those mentioned**

> **in paragraph (1) or in Article 7 (Income From Real Property) shall be taxable only in the Contracting State of which the alienator is a resident.** (Emphasis supplied)

Furthermore, the Reservation Clause of the same Treaty provides, in part, as follows:

> **Article 1**
>
> Notwithstanding the provisions of Article 14 of the Convention relating to capital gains, **both the Philippines and the United States may tax gain from the disposition of an interest in a corporation if its assets consist principally of a real property interest located in that country**. Likewise, both countries may tax gain from the disposition of an interest in a partnership, trust or estate to the extent the gain is attributable to a real property interest in one of the countries. **The term 'real property interest' is to have the meaning it has under the law of the country in which the underlying real property is located.** (Emphasis supplied)

Therefore, any gain that may be derived by a resident of the US from the alienation of its properties, other than those mentioned in paragraph (1) of Article 14 of the RP-US Tax Treaty, shall be taxable only in the US. However, under the Reservation Clause of the RP-US Tax

Treaty, the Philippines may tax the gains derived from the disposition of shares owned by a resident of the US in a domestic corporation, if the latter's assets consist principally of real property interests located in the Philippines.

Under RR No. 4-86 61 dated April 2, 1986, the term "Real Property Interest" shall be understood to include real properties as understood under Philippine laws. "Real Property Interest" means any properties enumerated in Section 3 of RR No. 4-86 62 which, are not, however, exclusive of others that are similarly situated. Moreover, the term "Principally" means more than 50°/o of the entire assets in terms of value.

In the case of (respondent), its Audited Financial Statements (AFS) for the years 2007 and 2008 reveal that the real property components of its property, plant and equipment (PPE) comprise less than 50°/o of its assets, detailed as follows:

PPE	**2007 AFS**	**2008 AFS**
Buildings and Improvements	P102,711,371.00	P113,090,661.00
Machinery and Equipment	657,910,953.00	606,029,874.00
Construction and Rehabilitation in Progress	29,944,006.00	35,686,346.00
Subtotal	P790,566,330.00	P754,806,881.00
Total Assets	2,607,410,808.00	2,058,270,304.00
% of Subtotal to Total Assets	30.32%	36.67%

Furthermore, as correctly pointed out by (respondent), the entire values of the PPE of (respondent) for the years 2007 and 2008, respectively, comprise less than 50°/o of its total assets for said years, respectively, to wit:

	2007 AFS	**2008 AFS**
PPE	P 820,806,675.00	P 774,302,761.00
Total Assets	2,607,410,808.00	2,058,270,304.00
% of Subtotal to Total Assets	31.48%	37.62%

Since (respondent's) assets do not consist principally of real property interest, the Reservation Clause of the RP-US Tax Treaty does not apply in this case. Accordingly, the net capital gain derived by GTRC in the redemption of its 3,729,216 preferred shares by (respondent) is exempt from the 5% or 10% capital gains tax imposed under Section 28(B)(5)(c) of the NIRC of 1997, as amended.

Since the net capital gain derived by GTRC from the redemption of its 3,729,216 preferred shares is exempt from the 5% or 10% capital gains tax imposed under Section 28(B)(5)(c) of the NIRC of 1997, as amended, the question arises as to whether said net capital gain (which is the component of the Redemption Price that pertains to the "accrued and unpaid dividends") is subject to the 15°/o FWT imposed under Section 28(B)(5)(b) of the NIRC of 1997, as amended, which provides that:

SEC. 28. *Rates of Income Tax on Foreign Corporations.* -

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(B) *Tax on Nonresident Foreign Corporation.* -

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(5) *Tax on Certain Incomes Received by a Nonresident Foreign Corporation.* -

x x x x x x x x x

> (b) *Intercorporate Dividends.* - A final withholding tax at the rate of fifteen percent (15%) is hereby imposed on the amount of cash and/or property dividends received from a domestic corporation, which shall be collected and paid as provided in Section 57(A) of this Code, subject to the condition that the country in which the nonresident foreign corporation is domiciled, shall allow a credit against the tax due from the nonresident foreign corporation taxes deemed to have been paid in the Philippines equivalent to twenty percent (20%), which represents the difference between the regular income tax of thirty-five percent (35%) and the fifteen percent (15%) tax on dividends as provided in this subparagraph: Provided, That effective January 1, 2009, the credit against the tax due shall be equivalent to fifteen percent (15%), which represents the difference between the regular income tax of thirty percent (30%) and the fifteen percent (15%) tax on dividends.

Under the RP-US Tax Treaty the definition and interpretation of what constitutes dividend income must be determined by the taxation law of the State of which the corporation making the distribution is a resident. Article 11(5) of the RP-US Tax Treaty states that:

> (5) The term 'dividends' as used in this Convention means income from shares, mining shares, founders' shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights assimilated to income from shares **by the taxation law of the State of which the corporation making the distribution is a resident**. (Emphasis supplied)

Thus, reference should be made to Philippine income tax laws and jurisprudence for purposes of determining whether the difference between the Redemption Price and the cost of the shares redeemed (in this case, par value) could be classified as dividends, for income tax purposes.

Section 73(A) of the NIRC of 1997, as amended, provides for the definition of "dividends" for income tax purposes, to wit:

> SEC. 73. *Distribution of Dividends or Assets by Corporations.* -
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> (A) *Definition of Dividends.* - The term 'dividends' when used in this Title means any distribution made by a corporation to its shareholders out of its earnings or profits and payable to its shareholders, whether in money or in other property.
>
> Where a corporation distributes all of its assets in complete liquidation or

> dissolution, the gain realized or loss sustained by the stockholder, whether individual or corporate, is a taxable income or a deductible loss, as the case may be.

The Supreme Court has already interpreted the above cited provision (which was formerly Section 25(a) of the Income Tax Law, Act No. 2833 of the Philippines, as amended by Section 4 of Act No. 3761) in the case of **Wise & Co., Inc. et al. vs. Bibiano L. Meer,**[6] as follows:

> In Holmby Corporation *vs.* Comm'r (83 Fed. [2d], 548-550), the court said:
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> ' ... the fact that the distributions were called 'dividends' and were made, in part, from earnings and profits, and that *some of them were made before liquidation or dissolution proceedings were commenced, is not controlling....* The determining element is whether the distributions were in the ordinary course of business and with intent to maintain the corporation as a going concern, or after deciding to quit and with intent to liquidate the business .... (Emphasis supplied.)
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> x x x x x x x x x
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> The amounts thus distributed among the plaintiffs were not in the nature of a recurring return on stock - in fact, they surrendered and relinquished their stock in return for said distributions, thus

[6] G.R. No. 48231, June 30, 1947.

> ceasing to be stockholders of the Hongkong Company, which in turn ceased to exist in its own right as a going concern during its more or less brief administration of the business *as trustee* for the Manila Company, and finally disappeared even as such trustee.
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> The distinction between a distribution in liquidation and an ordinary dividend is *factual;* the result in each case depending on the *particular circumstances of the case and the intent of the parties.* If the distribution is in the nature of a recurring return on stock it is an ordinary dividend. However, if the corporation is really *winding up its business* or recapitalizing and narrowing its activities, the distribution may properly be treated as in complete or partial liquidation and as payment by the corporation to the stockholder for his stock. The corporation is, in the latter instances, wiping out all parts of the stockholders' interest in the company.... (Montgomery, Federal Income Tax Handbook [1938-1939], 258; emphasis supplied.)

The difference therefore between the original acquisition cost of the shares and its purchase price in cases of liquidation, whether complete or partial, should be considered as capital gains but subject to ordinary income tax rates. Said difference or gain cannot be treated as dividends as it is not a recurring return on stock.

In this case, GTRC's net capital gain (the component of Redemption Price that pertains to the "accrued and unpaid dividends") could not be classified as "dividends" *per* se since they do not come from the corporation's unrestricted retained earnings or profits. As proven by (respondent), it did not declare and pay dividends to GTRC from the year 2003 to the year 2009 as (respondent) did not have unrestricted retained earnings during those years to cover any dividend declaration. Furthermore, said net capital gain does not represent a recurring return on the shares redeemed but as payment by (respondent) to GTRC for the redemption of the latter's 3,729,216 preferred shares. The net capital gain would not have been derived if not for the redemption of 3,729,216 preferred shares by (respondent).

Moreover, the Court noted that there is only one provision in the NIRC of 1997, as amended, which treats as dividends the gain derived from redemption or buy back of shares. Section 73(B) of the NIRC of 1997, as amended, refers to situations when *stock dividends* are redeemed whether pursuant to a partial or complete liquidation of corporations. Section 73(B) of the NIRC of 1997, as amended, is quoted hereunder:

> SEC. 73. *Distribution of Dividends or Assets by Corporations.* –
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> x x x x x x x x x
>
> (B) *Stock Dividend.* - A stock dividend representing the transfer of surplus to capital account shall not be subjected to tax. **However, if a corporation cancels or redeems stock issued as a dividend at such time and in**

> **such manner, as to make the distribution and cancellation or redemption, in whole or in part, essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock shall be considered as taxable income to the extent that it represents a distribution of earnings or profits.** *(Emphasis supplied)*

In the case of **Commissioner of Internal Revenue vs. The Court of Appeals, Court of Tax Appeals and A. Soriano Corporation,**[7] the Highest Tribunal made a pronouncement with regard to the application of Section 73(B) of the NIRC of 1997, as amended [then Section 83(b) of the NIRC], to wit:

> As qualified by the phrase 'such time and in such manner,' the exception was not intended to characterize as taxable dividend every distribution of earnings arising from the redemption of stock dividend. So that, whether the amount distributed in the redemption should be treated as the equivalent of a 'taxable dividend' is a question of fact, which is determinable on 'the basis of the particular facts of the transaction in question. No decisive test can be used to determine the application of the exemption under Section 83(b).
>
> x x x x x x x x x

[7] G.R. No. 108576, January 20, 1999.

> **For the exempting clause of Section 83(b) to apply, it is indispensable that: (a) there is redemption or cancellation; (b) the transaction involves stock dividends and (c) the 'time and manner' of the transaction makes it 'essentially equivalent to a distribution of taxable dividends.** xxx *(Emphasis supplied; citations omitted)*

Based on the above-cited provision of the NIRC of 1997, as amended, it is only in cases of redemption of shares previously issued as stock dividends that the difference between the par value of the shares and the redemption price may be treated as taxable dividends. The Supreme Court even clarified that the law did not intend to automatically characterize as taxable dividend every distribution of earnings arising from redemption of stock dividends as the taxability of said distribution as dividends will still have to be determined on a case to case basis.

In the instant case, Section 73(B) of the NIRC of 1997, as amended, will not apply. It is clear that the preferred shares redeemed by (respondent) from GTRC are not stock dividends and the Redemption Price received by GTRC could not amount to a distribution of profits since (respondent) did not have unrestricted retained earnings during the years 2003 to 2009.

Consequently, absent a law which specifically treats the same as dividends, the net capital gain derived by GTRC from the redemption of its 3,729,216 preferred shares should not be treated as dividends subject to 15% FWT under Section

28(B)(5)(c) of the NIRC of 1997, as amended. On this basis, (respondent) has indeed erroneously withheld and remitted to the BIR the 15% FWT in the amount of P14,659,847.10.

Records reveal that (respondent) was able to establish the erroneous withholding and remittance to the BIR of the 15% FWT in the amount of P14,659,847.10. In order to prove said withholding and remittance, (respondent) presented its Monthly Remittance Return of Final Income taxes Withheld and the Certification issued by the BIR dated October 26, 2010 confirming (respondent's) remittance of the FWT in the amount of P14,659,847.10.

x x x Moreover, the administrative and judicial claims for refund filed by (respondent), as withholding agent of GTRC, were filed within the two-year prescriptive period.

(Respondent) has also proven that the 15% FWT erroneously withheld and remitted to the BIR could not have been utilized by GTRC as tax credit in the US considering that (respondent) did not issue any Certificate of Final Taxes Withheld in favor of GTRC, which is necessary for GTRC to be able to claim the FWT in the amount of P14,659,847.10 as foreign tax credit against its income tax due in the US. (Respondent) likewise presented GTRC's AFS for the year 2008, which shows that GTRC suffered a net loss in the amount of US$77,000,000.00 and thus, it would not have any use for any foreign tax credit.

All told, this Court finds (respondent) entitled to a refund or tax credit in the amount of P14,659,847.10, representing erroneously withheld and remitted 15% FWT to the BIR.

Significantly, petitioner never pretended to dispute the facts as found by the Court in Division supported as they were by sufficient evidence presented during the trial of the case.

The findings of fact of the CTA, a highly specialized body that reviews tax cases, are not to be disturbed[8] unless clearly shown to be unsupported by substantial evidence,[9] which is not obtaining in the present case.

WHEREFORE, the Petition for Review dated July 26, 2013 filed by the Commissioner of Internal Revenue, is hereby **DENIED**, for lack of merit.

SO ORDERED.

ESPERANZA R. FABON-VICTORINO
Associate Justice

We Concur:

ROMAN G. DEL ROSARIO
Presiding Justice

JUANITO C. CASTAÑEDA, JR.
Associate Justice

(On Leave)
LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

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[8] Commissioner of Internal Revenue vs. United International Pictures, G.R. No. 169565, January 21, 2009.
[9] Microsoft Philippines, Inc. vs. Commissioner of Internal Revenue, G.R. No. 180173, April 06, 2011.

Cielito N. Mindaro-Grulla
CIELITO N. MINDARO-GRULLA
Associate Justice

AMELIA R. COTANGCO-MANALASTAS
Associate Justice

Ma. Belen
MA. BELEN M. RINGPIS-LIBAN
Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution, it is hereby certified that the above Decision has been reached in consultation with the members of the Court *En Banc* before the case was assigned to the writer of the opinion of the Court.

ROMAN G. DEL ROSARIO
Presiding Justice