REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

May 21/69

JOHN GOTAMCO & SONS, INC.,
Petitioner,

versus

CTA CASE NO. 1625

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

x - - - - - - - - - - - - - x

D E C I S I O N

This is an appeal from a decision of respondent Commissioner of Internal Revenue assessing petitioner the amount of ₱16,970.40 as contractor's percentage tax and 25% surcharge for the years 1957 and 1958.

It appears that on July 22, 1951, the World Health Organization, or the WHO for short, and the Government of the Republic of the Philippines entered into an agreement which, among other things, provided that the WHO is "exempt from all taxes direct or indirect . . ." When the WHO wanted to have a building for its offices that can also accommodate other United Nations offices stationed in Manila, it entered into another agreement with the Government of the Republic of the Philippines on November 26, 1957 regarding the said construction. In the said agreement the provision exempting the WHO from "all direct and indirect taxes" in the Agreement of July 22, 1951 was reiterated. Thereafter, a Bid Bulletin No. 1 was issued by WHO with the following provision:

> All proposals must take into account that the building belongs to an international organization with diplomatic status and is therefore, exempt from the payment of all fees, licenses, and taxes both local and national. These fees and licenses are in connection with construction permits and taxes and duties are those connected with the importation of building materials. Your proposal, therefore, must take this into account and should not include items for such taxes, licenses, and other payments to government agencies.

On February 10, 1958 the construction contract which is the subject of the assessment in question was executed by and between the WHO and petitioner John Gotamco & Sons, Inc., a corporation duly organized and existing by virtue of the laws of the Philippines. The stipulated contract price was for ₱370,000 but when the building was completed the price reached a total of ₱452,544.00. In connection with the aforesaid contract the WHO certifies that -

> This is to certify that the World Health Organization and the Government of the Republic of the Philippines entered into an agreement regarding the construction of a building to accommodate the World Health Organization and other United Nations offices stationed in Manila. This agreement was signed on 26 November 1957.

In Article III, Paragraph 2, it was stated that:

> "The Organization may import into the country materials and fixtures required for the construction free from all duties and taxes and agrees not to utilize any portion of the international reserves of the Government."

Article VIII of the above-mentioned agreement refers to the Host Agreement concluded on 22 July 1951 in which it was agreed that the Organization will be exempt from all direct and indirect taxes.

When the request for bids for the construction of the World Health Organization office building was called for, contractors were informed that there would be no taxes or fees levied upon them for their work in connection with the construction of the building as this will be considered an indirect tax to the Organization caused by the increase of the contractor's bid in order to cover these taxes. This was upheld by the Bureau of Internal Revenue and it can be stated that the contractors submitted their bids in good faith with the exemption in mind.

The undersigned, therefore, certifies that the bid of John Gotamco & Sons, made under the conditions stated above, should be exempted from any taxes in connection with the construction of the World Health Organization office building.

Sometime in May 1958 the WHO received the following opinion of the Commissioner of Internal Revenue:

2nd Indorsement
May 9, 1958

Respectfully returned to the Honorable, the Secretary of Finance, Manila.

Section 11 of the Host Agreement dated July 22, 1951 provides that "the organization, its assets, income and other property, shall be: (a) exempt from all direct and indirect taxes". As the 3% contractor's tax is an indirect tax on the assets and income of the Organization, the gross receipts derived by contractors from their contracts with the WHO for the construction of its new building, are exempt from tax in accordance with the above quoted provisions of the Host Agreement.

(SGD.) JOSE ARAÑAS
Commissioner of Internal Revenue

On June 3, 1958, the aforesaid Commissioner reversed the afore-quoted opinion. The reversal reads as follows:

2nd Indorsement
June 3, 1958

Respectfully returned to the Honorable, the Secretary of Finance, Manila.

Section 11 of the Host Agreement dated July 23, 1951 provides that "the organization, its assets, income and other property shall be: (a) exempt from all direct and indirect taxes." As the 3% contractor's tax is not a direct nor an indirect tax on the WHO, but is a tax that is primarily due from the contractor, the same is not covered by the above quoted provision of the Host Agreement.

JOSE ARAÑAS
Commissioner of Internal Revenue

In view of the aforesaid reversal, respondent made the assessment which is now on appeal before this Court.

The principal issue in the present case rests on the interpretation of Section 11 of the Agreement of the World Health Organization and the Government of the Republic of the Philippines of July 22, 1951 which provides that "The organization, its assets, income and other properties shall be: (a) exempt from all direct and indirect taxes . . ." a provision that was reiterated in the Agreement of November 26, 1957 by the same parties in connection with the construction of the building in question. Respondent's position is that the contractor's tax is "in the nature of an excise tax which is a charge imposed upon the performance of an act, the enjoyment of a privilege or the engaging in an occupation" and is "a tax due primarily and directly on the contractor, not on the owner of the building." Respondent further alleged that "since the tax has no bearing upon the World Health Organization, it can not be deemed an indirect taxation upon it." We do not subscribe to this opinion. The fact that the contractor's tax is an excise tax to be paid by the contractor does not necessarily mean that it cannot be an indirect tax upon the WHO.

In context, direct taxes are those that are demanded from the very person who, it is intended or desired, should pay them; while indirect taxes are those that are demanded in the first instance from one person in the expectation and intention that he can shift the burden to someone else. (Pollock v. Farmers, L & T Co., 157 US 429, 15 S.Ct. 673, 39 Law. Ed. 759.) The contractor's tax is of course payable by the contractor but in the last analysis it is the owner of the building that shoulders the burden of the tax because the same is shifted by the contractor to the owner as a matter of self-preservation. Thus, it is an indirect tax. And it is an indirect tax on the WHO because, although it is payable by the petitioner, the latter can shift its burden on the WHO. In the last analysis it is the WHO that will pay the tax indirectly through the contractor and it certainly cannot be said that "this tax has no bearing upon the World Health Organization."

Respondent's theory would obviously limit the tax exemption provided for the WHO with respect to the indirect taxes to those that by provision of law are payable by the WHO in the first instance the burden of which may however be shifted by it onto another. This would do violence to the clear intent of the exemption.

A tax exemption is granted to relieve the grantee from the burden resulting from the tax. The obvious intent of the exemption in question is to relieve the WHO from shouldering the burden resulting from direct and indirect taxes without any limitation or condition other than those provided in the agreements. There is nothing in said agreements that limits the scope of the exemption from indirect taxes to cases where the WHO pays the tax in the first instance but can shift the burden thereof to another and we see no reason to read such a limitation into the agreements. Indeed, imposing such a limitation would lead to absurd results. If we limit the scope of the exemption to indirect taxes that are payable in the first instance by the WHO, the insertion of the word "indirect" would be purposeless because the WHO can easily pass the burden to another. On the other hand, the WHO will not be relieved of the burden imposed by the indirect taxes that are shifted to it by whoever pays the tax in the first instance. The word "indirect" would thus appear like an ironic insertion. A tax exemption should not be interpreted in a manner that thwarts the purpose and destroys its spirit. (The Law of Taxation, Cooley, Vol. II, p. 1416, citing Spokane Valley Land & Water Company v. Kootenai, Idaho, 199 Fed. 481.)

In holding that the WHO is exempt from the burden of the contractor's tax because of the exemption from indirect taxes, we are not unmindful of the case of Philippine Acetylene Co., Inc. v. Commissioner of Internal Revenue and Court of Tax Appeals (G.R. No. L-19707, August 17, 1967) where the seller was held liable for sales taxes for sales made to the National Power Corporation, an agency of the Philippine Government, which is tax-exempt under these terms:

> "SEC. 2. To facilitate the payment of its indebtedness, the National Power Corporation shall be exempt from all taxes, except real property tax, and from all duties, fees, imposts, charges, and restrictions of the Republic of the Philippines, its provinces, cities and municipalities."

We note that in the decision of said case it was said that -

> "Many years ago, Mr. Justice Oliver Wendel Holmes expressed dissatisfaction with the use of the phrase 'pass the tax on.' Writing the opinion of the U.S. Supreme Court in Lash's Products v. United States, he said: 'The phrase "passed the tax on" is inaccurate, as obviously the tax is laid and remains on the manufacturer and on him alone. The purchaser does not really pay the tax. He pays or may pay the seller more for the goods because of the

> seller's obligation, but that is all. * * * The price is the sum total paid for the goods. The amount added because of the tax is paid to get the goods and for nothing else. Therefore it is part of the price * * *."

and we further note that in the light of the foregoing quotation the Court held that the sales tax is a tax on the seller and the fact that the seller may pass the burden on the National Power Company does convert the same into a tax on the latter for the purpose of the exemption.

We think that the Philippine Acetylene Co., Inc. case aforesaid is not applicable to the present. The exemption of the National Power Company merely states "that the corporation shall be exempt from all taxes . . ." In the instant case the agreement states that it shall be "exempt from all direct and indirect taxes." It goes without saying that the State may exempt any entity, not only from the burden of taxes that are directly payable by it, but also from the ultimate burden of an indirect tax that the payer may pass on to it, and this we think is what the Agreements of July 22, 1951 and November 26, 1957 purport to do when they used the phrase "exempt from all direct and indirect taxes."

Section 12 of the Agreement of July 22, 1951, aside from what we have said further above, brings home our point. Said Section provides that -

> While the Organization will not, as a general rule, in the case of minor purchases, claim exemption from excise duties, and from taxes on the sale of movable and immovable property which form part of the price to be paid, nevertheless, when the Organization is making important purchases for official use of property on which such duties and taxes have been charged or are chargeable the Government of the Republic of the Philippines shall make appropriate administrative arrangements for the remission or return of the amount of duty or tax. (Underscoring supplied.)

The foregoing provision clearly relieves the WHO from the burden of the sales taxes in its purchases and yet the sales tax is payable by the seller, not the purchaser. And it should be noted in this connection that Section 12 aforesaid is so phrased that it appears like a waiver of a previously stipulated exemption and the only provision to which this waiver can be linked is the exemption from "all direct and indirect taxes" in Section 11. It would thus seem that the agreements of July 22, 1951 and November 6, 1957 intended to relieve the WHO from taxes that it indirectly pays because this burden ultimately falls on them; the agreements expressed this intention not in so many words, but in the phrase "exempt from all direct and indirect taxes."

We do not think that our interpretation of the tax exemption in question violates the rule on strict construction which means no more than that such provisions should be interpreted so as to carry out its expressed intention. (Soughton v. City of Hartford, 85 Conn. 674, 84 Atl. 95.) And we may even say further that since the underlying principles of our system of taxation are of American origin perforce the established doctrines there recognizing exceptions to strict construction may justifiably be accepted here in this jurisdiction especially since our tax jurisprudence is abundantly dotted with American authorities. Thus, says Cooley in this respect:

> While in some states exemptions of religious, charitable and educational property or institutions are strictly construed, <u>the better rule seems to be that laid down in some states requiring a liberal rather than a strict construction in such cases or at least that the same strictness of construction will not be indulged where the exemption is of such institutions</u>. (The Law of Taxation, Cooley, Vol. II, p. 674; underscoring supplied.)

The WHO is not a mercantile corporation but is a benevolent institution that has come here to help us in the fight against diseases and to help promote the health of the people, bringing its own funds. Considering the nature of the WHO, its aims and functions, its tax exemption should be con-construed, if not liberally, at least not with the same strictness with which tax exemptions are generally construed.

Respondent urges that the evidence on record shows that the contractor's tax was not discounted from the contract price. In support of this pretension respondent points Bid Bulletin No. 1 adverted to further above which allegedly mentions only permits, and purchases of materials. Scanning further said Bid Bulletin, however, one will find that it also mentions all payments to the government. As against this Bid Bulletin, we have the certification of the WHO to the effect that the prospective contractors were advised to take into account that the WHO was exempt from the payment of all indirect taxes. We find no valid reason for doubting the veracity of this certification which finds corroboration from the fact that the WHO in effect obtained an opinion from the then Commissioner of Internal Revenue holding that the 3% contractor's tax is an indirect tax included in the exemption of the WHO. On top of all these, the record of the Bureau of Internal Revenue shows that the only point the Bureau raised during the investigation of the assessment in question was the applicability of the exemption to the construction contract between petitioner and the WHO.

Respondent lastly urges that the exemption in question is exclusively for the WHO and cannot be extended to the petitioner being personal in nature. It should be recalled that the exemption from all direct and indirect taxes was reiterated in the Agreement of November 26, 1957 of the WHO and the Government of the Republic of the Philippines which was to govern the construction in question. The exemption has thus attached itself to the construction and is not just personal to the WHO. At any rate, assuming arguendo that it is personal to the WHO the fact is that the WHO did use it when it advised the petitioner to take it into consideration in submitting its price; it is not the petitioner that uses it now in the last analysis.

WHEREFORE, the appealed decision is hereby reversed without pronouncement as to costs.

SO ORDERED.

Quezon City, May 21, 1969.

RAMON L. AVANCEÑA
Associate Judge

I CONCUR:

ROMAN M. UMALI
Presiding Judge