REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SYNTHETIC TEXTILE MANUFACTURERS CO., INC., Petitioner,

- Versus - C.T.A. CASE No. 1854

MISAEL P. VERA, as Commissioner of Internal Revenue, Respondent.

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July 13/73

D E C I S I O N

Petitioner has appealed from the decision of respondent Commissioner of Internal Revenue, dated March 16, 1967, assessing against and demanding from petitioner payment of ₱9,267.75, ₱116,223.00, and ₱164,870.15 as deficiency withholding taxes on interests remitted to foreign suppliers in 1961, 1962 and 1963, inclusive of surcharges, interests and compromise penalties, computed as follows:

1 9 6 1

Total amount of interests remitted	₱ 21,419.01
30% withholding tax due thereon	₱ 6,425.00
Add: 25% surcharge	1,606.25
½% mo. int. from 4-17-62 to 4/17/65	1,156.50
Compromise for failure to file and pay	80.00
Total amount due and collectible	₱ 9,267.75

1 9 6 2

Total amount of interests remitted	₱387,001.44
30% withholding tax due thereon	₱116,100.00
Add: 25% surcharge	29,025.00

1 9 6 2 (Cont'd)

½% mo. int. from 4-17-63 to 4-17-66 ...	₱ 20,898.00
Compromise for failure to file and pay	200.00
Total amount due and collectible	₱116,223.00

1 9 6 3

Total amount of interests remitted	₱385,193.10
30% withholding tax due thereon	₱115,558.00
Add: 25% surcharge	28,889.50
½% mo. int. from 4-16-64 to 3/16/67 ...	20,222.65
Compromise for failure to file and pay	200.00
Total amount due and collectible	₱164,870.15

Petitioner is a domestic corporation located at Sheridan St., Mandaluyong, Rizal. On September 22, 1959, petitioner was authorized by the Central Bank of the Philippines to import from Switzerland and West Germany textile mill machineries, equipment, accessories and spare parts with a total value of $3,082,381.74, inclusive of $323,789.74 as interests on deferred payment.

Under said authority, petitioner entered on February 16, 1960 into an agreement with the syndicate of banks, namely: Philippine National Bank, Prudential Bank and Trust Company, Security Bank and Trust Company, and Commercial Bank and Trust Company, wherein the said banks agreed to open jointly "irrevocable revolving without recourse" deferred letters of credit for a period of six (6) years in favor of Swiss and German suppliers of textile mill machineries, etc., amounting to $3,082,381.74 in the proportion of 56.2% for the Philippine National Bank, 16.2% each for the Prudential Bank & Trust Company and the Security Bank and Trust Company, and 11.4% for the Commercial Bank and Trust Company. (Exhs. 5 and B, Folder No. 1 of Exhibits, pp. 4-6, t.s.n., Oct. 23, 1967; p. 172, t.s.n., July 14, 1971.)

Before petitioner was allowed to open all letters of credit connected with the said importations, the syndicate of banks required petitioner to state in its application or proposal, the following obligation, to wit:

> 3. That before the establishment of the revolving stand-by letter of credit, you will give the banks an undertaking acceptable in form and substance to the banks whereby you assume all exchange risks as well as all taxes and duties and other levies now applicable or which may be applicable during the currency of the stand-by letter of credit on all or part of the machinery and equipment financed, including the necessary foreign exchange on the due dates the drawings of the letter of credit will be made. (Exhs. 5 and B and 5-A, pp. 4-6, Folder No. 1 of Exhibits; Underlining ours.)

and to mortgage its land, factory and office building, bodega, machinery and equipment, as well as to hold in trust the machinery, equipment, accessories and spare parts to be imported under the above-mentioned letters of credit until full amount of the obligation of petitioner to the banks shall have been paid. (Exhs. 5 and B, ibid; and 6 and C, pp. 7-8, Folder No. I of Exhibits.)

In 1960, petitioner filed with the syndicate of banks the said application for opening letters of credit to secure payment of the purchase price plus interests on deferred payments of the imported textile mill machineries, etc., as authorized by the Central Bank. Thereafter, the syndicate of banks headed by the Philippine National Bank opened the letters of credit in favor of the foreign suppliers of the textile mill machineries, etc., needed by petitioner. Under said letters of credit, the syndicate of banks agreed to pay the foreign suppliers, thru the PNB's correspondent banks abroad, an initial amount of 10% of the C & F value of the imported machinery plus interest one year after the shipment and the balance of 90% payable six months after delivery of each shipment. (Exh. A, Folder No. I of Exhibits, pp. 1-3; pp. 118-122, t.s.n., Sept. 17, 1969.)

The imported machineries, etc., covered by the letters of credit were directly "consigned" by the foreign suppliers to the Philippine National Bank as shown by the bills of lading. The said machineries, etc., were released by the PNB to the petitioner after it had executed deeds of trust or trust receipts in favor of the said bank. After the shipment of the textile mill machineries, etc., the drafts drawn by the foreign suppliers were paid to them and/or their indorsees or payees in 1961, 1962 and 1963 by the syndicate of banks thru their correspondents abroad, namely: Philippine National Bank, New York; and Chase Manhattan Bank, New York. The said payments include the interests due the foreign suppliers.

Respondent ruled that petitioner is the withholding agent of the interests paid to the foreign suppliers and, therefore, subject to the withholding income taxes imposed by Section 54, in relation to Section 53, of the National Internal Revenue Code. Consequently, petitioner requested reconsideration of respondent's ruling and assessment by claiming that it is not subject to the payment thereof. Petitioner's request was, however, denied by respondent. Hence, this appeal.

The only issue posed for resolution is whether or not petitioner is the withholding agent liable for deficiency withholding income taxes plus penalties on interests paid in 1961, 1962 and 1963 to the foreign suppliers of imported machineries.

In resisting payment of the withholding income taxes assessed by respondent, petitioner relied on the provisions of Sections 53 and 205 of the National Internal Revenue Code and Revenue Regulations No. 2 of the Department of Finance. Section 53(b) of the Revenue Code provides as follows:

> Sec. 53. Withholding of tax at source.-
>
> x x x x
>
> (b) Nonresident aliens. - All persons, corporations and general copartnerships (compañias colectivas), in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, receivers, conservators, fiduciaries, employers, and all officers and employees of the Government of the Philippines having the control, receipt, custody, disposal, or payment of interest, dividends, rents, salaries, wages, premiums, annuities, compensation, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income of any non-resident alien individual, not engaged in trade or business within the Philippines and not having any office or place of business therein, shall (except in the cases provided for in subsection (2) of this section) deduct and withhold from such annual or periodical gains, profits, and income a tax equal to twenty per centum thereof: Provided, That no such deduction or withholding shall be required in the case of dividends paid by a foreign corporation unless (1) such cor-

> poration is engaged in trade or business within the Philippines and (2) more than eighty-five per centum of the gross income of such corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the Philippines as determined under the provisions of section thirty-seven: Provided, further, That the Commissioner of Internal Revenue may authorize such tax to be deducted and withheld from the interest upon any securities the owners of which are not known to the withholding agent. (As amended by sec. 9, Republic Act No. 82; sec. 7, Republic Act No. 590; and sec. 9, Republic Act No. 2343.)

From the above quoted provisions of the National Internal Revenue Code, a withholding agent of withholding tax at source may be a person, corporation, general copartnership, including mortgagor of real or personal property, etc., who has the control, receipt, custody, disposal or payment of "interest" received or obtained from sources within the Philippines by a non-resident alien, whether individual or corporation, not engaged in business or trade in the Philippines and not having an office or place of business therein.

Respondent Commissioner of Internal Revenue alleges that petitioner is the withholding agent of the interest income of the foreign suppliers because the relationship of petitioner and the syndicate of banks is that of principal and agent. This is so because petitioner is the direct importer of the machineries, etc., while the syndicate of banks, headed by the PNB, is the agent of petitioner in the payment of the principal and interest. Consequently, the failure of the syndicate of banks to deduct, withhold and pay the income tax due on the interests remitted to the foreign suppliers of imported machineries does not relieve petitioner from its liability under Sections 53 and 54 of the Tax Code because petitioner as the principal is the one directly liable to deduct, withhold and pay the tax in question. Moreover, petitioner had proposed and agreed to assume all taxes and duties as a condition required for the opening of the letters of credit by the syndicate of banks.

Petitioner, however, contends that it could not be the withholding agent of the Government because it had no custody or control of the interests paid to the foreign suppliers of imported machineries and denies that petitioner and the syndicate of banks are principal and agent. It asserts that an importer who has procured a letter of credit to facilitate the purchase of goods abroad does not have control over the payments made by the syndicate of banks on the drafts drawn under the letter of credit; and the said syndicate of banks assumed an original or primary obligation in the payment of interest because as between the issuer of a letter of credit and its customer, their respective rights, duties and liabilities are governed by the agreement between the two and the issuer of a letter of credit is, with regard to the customer, an independent contractor and not his agent.

Despite the contentions and arguments of both parties, the provisions of Section 53(a)(1) applicable to this case read as follows:

> Sec. 53. Withholding of tax at source.- (a) Tax-free covenant bonds - (1) Requirement of withholding.- In any case where bonds, mortgages, deeds of trust, or other similar obligations of domestic or resident foreign corporations, contain a contract or provision by which the obligor agrees to pay any portion of the tax imposed by this Title upon the obligee or to reimburse the obligee for any portion of the tax or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon or to retain therefrom under any law of the Philippines, or of any state or country, the obligor shall deduct and withhold a tax equal to twenty per centum of the interest upon such bonds, mortgages, deeds of trust, or other obligations, whether such interest is payable annually or at shorter or longer periods, and whether such bonds, obligations, or securities had been heretofore or are hereafter issued or marketed, and the interest thereon paid, within or without the Philippines if such interest is payable to a nonresident alien individual or to a citizen or resident of the Philippines. (As amended by Sec. 9, Republic Act No. 2343.)

The foregoing provisions require the obligor to deduct and withhold a tax of 20% of the interest upon such bonds, mortgages, deed of trust, or other obligations. The said requirement is applicable to this case because petitioner entered into a contract wherein the obligor agrees to pay the tax imposed by this Title (Withholding Tax) upon the obligee.

It is to be noted that before the establishment of the stand-by letters of credit by the syndicate of banks, petitioner entered into an agreement with said banks and undertook, among others, the following obligations:

1. Assume all taxes and duties and other levies now applicable or which may be applicable during the currency of the stand-by letters of credit;

2. Mortgage its land, factory and office building, bodega, machinery and equipment; and

3. Hold in trust the imported machinery, equipment, accessories and spare parts covered by the letters of credit until the full amount of obligation of petitioner to the banks shall have been paid.

The question of whether or not the syndicate of banks is an agent of petitioner or an independent contractor is not decisive in resolving the issue posed for resolution. Under Section 53(a)(1) of the Tax Code, supra, the relationship to be determined between Synthetic Textile Manufactures Co., Inc., and the syndicate of banks is the identity of the obligor and the obligee. The terms obligor and obligee have been defined as follows:

O B L I G O R

> One who binds himself, or gives his bond to another; one who places himself under a legal obligation; - correlative to obligee. (Webster's International Dictionary, Second Ed.)
>
> A person subject to a contractual duty or liable to a breach of contract. (Words and Phrases, Vol. 29, p. 65 Permanent Ed.)

O B L I G E E

> One to whom another is obligated; one toward whom another had undertaken an obligation - opposed to obligor. (Webster's International Dictionary, Second Ed.)
>
> The person to whom the duty is owed. (Words and Phrases, Vol. 29, p. 64, Permanent Ed.)

From the foregoing definitions, it is abundantly clear that the herein petitioner is the obligor because it had a contractual obligation with the syndicate of banks to pay all taxes, duties and levies; mortgage its real and personal properties; and hold in trust the imported textile mill machinery, etc., until petitioner's indebtedness and obligation to the syndicate of banks were paid in full. Consequently, under Section 53(a)(1) of the Tax Code, <u>supra</u>, in relation to the agreement entered into by the petitioner and the syndicate of banks, the said petitioner is the obligor who is subject to deduct, withhold, and pay the tax on the interests paid to the foreign suppliers of textile mill machinery, etc. This is especially true in the case at bar where petitioner was invariably notified by the syndicate of banks before the stand-by letters of credit were remitted and paid to the said foreign suppliers of the imported textile mill machinery, etc.

Moreover, under Section 53(b) of the Tax Code, supra, the terms persons, corporations, or general co-partnerships include mortgagors of real or personal property and trustees acting in any trust capacity who have the control, custody, disposal, or payment of the interest to a non-resident alien. In short, they are the parties subject to the withholding income tax. Under the terms of the agreement entered into by petitioner and the syndicate of banks, it is the petitioner who has the control, custody, disposal or payment of the interests earned or realized by the foreign suppliers of textile mill machinery, etc., unless the said interests were paid in advance by petitioner to the syndicate of banks. But assuming arguendo that the syndicate of banks has the control, custody, disposal, or payment of interest and the same were remitted and paid out of their funds to the foreign suppliers of textile mill machinery, etc., still petitioner is liable for any breach of contract to the syndicate of banks and, therefore, it is subject to the withholding income tax and to whatever damages incurred by the said banks.

We are, therefore, of the opinion and hold that the herein petitioner is either the obligor, mortgagor, or trustee of the syndicate of banks. As such, it is required by Section 53(a)(1) and (b) of the Tax Code, supra, to deduct, withhold, and pay the income tax assessed by the respondent.

WHEREFORE, the decision of the respondent Commissioner of Internal Revenue appealed from is affirmed, except the compromise penalties. Consequently, petitioner is hereby ordered to pay to the said respondent or his duly authorized collection agent the withholding income taxes, surcharges, and interests assessed against and due from petitioner. With costs against said petitioner.

SO ORDERED.

Quezon City, July 13, 1973.

Estanislao R. Alvarez
ESTANISLAO R. ALVAREZ
Associate Judge

WE CONCUR:

R M Umali
ROMAN M. UMALI
Presiding Judge

Ramon L Avanceña
RAMON L. AVANCEÑA
Associate Judge