REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

MITSUBISHI CORPORATION – MANILA BRANCH,
Petitioner,

- versus -

C.T.A. CASE NO. 6139

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

DEC 17 2003

x - x

DECISION

This case involves a claim for refund of erroneously paid income tax and branch profit remittance tax for the fiscal year ended March 31, 1998 amounting to P44,288,712 and P8,324,100, respectively, arising from petitioner's Overseas Economic Cooperation Fund - funded Batangas Coal-Fired Thermal Power Plant Project.

Petitioner is the Philippine Branch of Mitsubishi Corporation, a corporation duly organized and existing under the laws of Japan and duly licensed to engage in business in the Philippines, with office address at the 14th Floor, L.V. Locsin, Building, 6752 Ayala Avenue, Makati City, Metro Manila ***(par.1, Joint Stipulation of Facts and Issues)***.

Through an Exchange of Notes between the Government of Japan and the Government of the Philippines dated June 11, 1987 ***(Exhibit "J")***, 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 (hereinafter, "OECF"), (now the Japan Bank for International Cooperation or "JIBC") for the implementation of the Calaca II Coal-Fired Thermal Power Plant Project (hereinafter, Calaca II Project).

In paragraph 5(2) of the said Exchange of Notes, it was stated that:

"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" ***(Exhibit "J")***.

Subsequently, 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 ***(Exhibit "O")***.

On June 21, 1991, the National Power Corporation (hereinafter, "NPC") and Mitsubishi Corporation, petitioner'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) (hereinafter, "Contract") ***(Exhibit "I")***.

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. Corporation (NPC) shall secure additional financing from OECF for Phase II within one (1) year after the date of Contract effectivity ***(Exhibit "I")***.

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 ***(Exhibit "P")***.

The Calaca II Project was completed by the petitioner 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 ***(Exhibit "D")***.

On July 15, 1998, petitioner filed its Income Tax Return for the fiscal year ended March 31, 1998 with the Bureau of Internal Revenue ***(par. 3, Joint Stipulation of Facts and Issues; Exhibits "B", "B-1" and "B-2")***. In the return, petitioner (being the Manila Branch of Mitsubishi Corporation) reported an income tax due of P90,481,711.00 computed in accordance with the provisions of Revenue Memorandum Order ("RAMO") No. 1-95, as follows:

Solicitation and Trading Activities		
Worldwide Operating Income		P6,421,609,029.00
Sales to the Philippines	15,342,816,283.00	
Worldwide Sales	3,281,557,773,404.00	.004675467
Taxable Income from Solicitation Activities		30,024,023.00
Attribution Rate		75%
		22,518,017.00
Taxable Income April-December 1997	16,888,513.00	
Tax Rate	35%	5,910,980.00
Taxable Income January-March 1998	5,629,504.00	
Tax Rate	34%	1,914,031.00
Tax Due from solicitation and trading activities		P7,825,011.00
Construction and Other Activities		
Taxable Income April-December 1997		236,162,001.00
Tax Rate		35%
Tax due from construction and other activities		P82,656,700.00
Total Tax Due		**P90,481,711.00**

(Exhibits "B-3", "B-6" and "B-7")

In computing the P90,481,711.00 income tax due for fiscal year ended March 31, 1998, petitioner included as part of its taxable income, all revenues earned and cost incurred for its Calaca II Project, in accordance with the completed contract method of reporting income ***(Exhibit "B")***.

The net income from the Calaca II Project amounted to P151,997,705, computed below:

Revenue	P1,416,829,241
Less: Project Cost	1,111,706,964
Gross Profit	305,122,277
Less: Operating Expenses	74,162,777
Income from Operations	230,959,500
Add: Other Income	3,482,413
Income Before Income Tax	234,441,913
Provision for Income Tax	82,444,208
Net Income	**P151,997,705**

(Exhibit "B-16")

Likewise, on July 15, 1998, petitioner filed its Monthly Remittance Return of Income Taxes Withheld ***(Exhibit "C")*** and remitted the amount of P8,324,100 representing its branch profit remittance tax (BPRT) for branch profits remitted to the 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, the respondent issued Bureau of Internal Revenue Ruling No. DA-407-98 ***(Exhibit K)*** where it held 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"* ***(par. 5, Stipulation of Facts, Joint Stipulation of Facts and Issues)***.

Of the P1,416,829,241.00 ***(Exhibit "B-16")*** total revenue from the Calaca II Project, P640,907,792 or 45.24% represents that portion which was not OECF-funded considering that this amount represents the Philippine Peso component of the project, while P775,921,449 or 54.76% represents the OECF funded portion ***(Exhibit N)***.

Since petitioner paid P82,444,208.00 income tax for its income from the entire Calaca II Project (inclusive of the OECF-funded and non-OECF funded portions) and P8,324100.00 BPRT for the remittance of its income (inclusive of the income on the OECF-funded portion of the Calaca II Project), petitioner now seeks a tax refund/credit of the P44,288,712 erroneously paid income tax and the P8,324,100.00 erroneously paid BPRT computed hereunder as follows:

Erroneously Paid Income Tax on Calaca II Project

		Explanation
Income Taxes Paid	P82,444,208 ==========	- for income attributable to the Calaca II Project
Sales	P640,907,792	- non-OECF funded portion
Less: Project Cost	502,936,230	- P1,111,706,964 (Total Project Cost) x 45.24% (non-OECF funded portion)
Gross Profit	137,971,562	
Less: Operating Expenses	33,551,240	- P74,162,777(total operating expenses) x 45.24% (non-OECF funded portion)
Income from Operation	104,420,322	- pertaining to the non-OECF funded portion
Add: Other Income	3,482,413	
Income before tax	107,902,735	
Add:	1,112,967	
Taxable Income	109,015,702	- pertaining to the non-OECF funded portion
Income tax due	38,155,496 ===========	- pertaining to the non-OECF funded portion
Income taxes paid for the entire project	82,444,208	
Income tax due	38,155,496	
Erroneously paid Income taxes	**P44,288,712** ============	- pertaining to the OECF funded portion and, therefor, should not have been paid by Mitsubishi

(Exhibit "A")

Erroneously Paid Branch Profit Remittance Tax Pertaining to Branch Profits from OECF Funded Potion of Calaca II Project

Net Income from Calaca II Project	151,997,705
Divided by: Total Revenue	1,416,829,241
Ratio of Net Income to Total Revenue	**10.728%** ===========
OECF Funded portion of Calaca II Project	775,921,449
x Ratio of Net Income to Total Revenue	10.728%
Net income from OECF-funded Portion	83,240,998
Multiply by BPRT Rate	10%
Erroneously paid BPRT	**P8,324,100*** ============

*pertaining to the income from the OECF funded portion and, therefore, should not have been paid by Mitsubishi

(Exhibit "A")

On June 30, 2000, petitioner filed an administrative claim for refund and/or tax credit with respondent in the amount of P52,612,812.00, representing its erroneously paid income taxes 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 as computed above ***(par. 6, Stipulation of Facts, Joints Stipulation of Facts and Issues; Exhibits "A" and "A-1").***

On July 13, 2000, petitioner, in order to suspend the running of the two-year period within which to file a judicial claim for refund, filed the instant petition for review pursuant to Section 229 of the Tax Code.

Respondent, on September 12, 2000, filed his answer raising the following Special and Affirmative Defenses, to wit:

> "7. Petitioner's alleged claim for refund is subject to administrative routinary investigation/examination by respondent's bureau.
>
> 8. Since BIR Ruling No. DA-407-98 is based merely on petitioner's self-serving representations and not on actual investigation by respondent, petitioner must prove with evidence its applicability to the instant case.
>
> 9. Taxes are presumed to have been collected in accordance with law.
>
> 10. In action for refund/credit, the burden of proof is on the taxpayer to establish its right to refund and its failure to sustain the burden is fatal to the claim for refund/credit.
>
> 11. Petitioner must show that it has complied with the provisions of Sections 204(c) and 229 of the Tax Code."

On April 6, 2001, petitioner, by leave of court, moved for the adoption of the procedure under CTA Circular No. 1-95, as amended by CTA Circular No. 10-97 which was granted by this court on April 23, 2001. Mr. Ruben R. Rubio, a partner of Sycip Gorres Velayo & Co. was commissioned to examine and verify the voluminous documents supporting petitioner's claim. Thereafter, on August 28, 2001, Mr. Ruben R. Rubio submitted his report ***(Exhibit "S")*** relative to his verification of petitioner's claim for refund. The report reveals an erroneously paid income tax and erroneously paid branch profit remittance tax amounting to P44,288,712 and P8,324,100, respectively. This court noted that there is no discrepancy between the amount cited in the report and the amount being claimed by petitioner.

In support of its claim for refund petitioner, presented documentary and testimonial evidence. On the contrary, respondent did not present any testimonial or documentary evidence to dispute the claim of petitioner.

On May 23, 2003, petitioner filed its memorandum. On the other hand, respondent, despite the extension given by this court for him to file his memorandum, failed to file the same. And so, this court, in its resolution dated July 15, 2003, submitted this case for decision.

The issues to be resolved by this court as stipulated by the parties are as follows:

1. Whether petitioner has erroneously paid income and branch profit remittance taxes for the fiscal year ended March 31, 1998, which is a proper claim for refund pursuant to Sections 204 and 229 of the Tax Code; and
2. Whether the erroneously paid income and branch profit remittance taxes for the fiscal year ended March 31, 1998 are substantiated by documentary evidence.

We are now going to discuss the first issue.

Records reveal that petitioner anchored its claim for refund on BIR Ruling No. DA-407-98, dated September 7, 1998 ***(Exhibit K)*** interpreting Item 5, paragraph 2 of the Exchange of Notes, which we herein quote for easy reference, to wit:

DA-407-98
9-7-98

Sycip Gorres Velayo & Co.
6760 Ayala Avenue
Makati City

Attn.: Atty. C. P. Noel
Tax Division

Gentlemen:

This refers to your letter dated May 15, 1998 requesting on behalf of your client, Mitsubishi Corporation-Manila Branch, for a ruling regarding the tax consequences of its OECF-funded NAIA II and Calaca II Projects.

It is represented that your client, Mitsubishi Corporation (Mitsubishi), is a private corporation duly organized and existing under and by virtue of the laws of Japan; that Mitsubishi was duly authorized by the Securities and Exchange Commission to operate a branch in the Philippines; that Mitsubishi is a member of the MTOB Consortium, the consortium which was granted the NAIA II Project is 75% foreign-funded by the government of Japan through the OECF and 25% as counterpart fund of the Philippine Government; the funding of this project was made pursuant to an Exchange of Notes (Notes-NAIA) between the Government of Japan and the Philippines; that under Notes NAIA, a loan in Japanese Yen up to the amount of Y47,036,000,000.00 was extended to the Philippine Government to fund, among other projects stated therein, the Ninoy Aquino International Airport Terminal 2 or the NAIA II project; that the NAIA II Project was allocated Y18,120,000,000.00; that item 7, paragraph 2 of Notes-NAIA states:

> "7 x x x
>
> (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/or services of Japanese nationals to be provided under the Loan.

It is likewise represented that on June 21, 1991, Mitsubishi entered into a contract with the National Power Corporation (NPC) for the supply of equipment and services, engineering, construction, testing and commissioning of equipment in connection with the Calaca II Project; that funding of the project is made through a grant from the Japanese Government through the OECF and pursuant to an Exchange of Notes dated June 11, 1987 (Notes-Calaca); that under the Notes-Calaca, a loan up to Y40,400,000,000.00 was extended expressly to implement the Calaca II Project; that Item 5, paragraph 2 Notes-Calaca provides;

> "5 x x x
>
> (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.)***
>
> It is further represented that the above contributions of the Japanese Government through the OECF represents 75% of the NAIA II Projects and 100% of the foreign currency portion of the Calaca II project both of which will benefit not Japan but the Philippines; and that under Notes-NAIA and Notes-Calaca, any income, value added tax or the other fiscal levies that may arise therefrom should not be made the obligation of Japanese firms engaged in the Projects.
>
> 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, Mitsubishi in this case, and Japanese nationals operating as suppliers, contractors or consultants involved in either of the two projects 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).
>
> 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.
>
> This ruling is being issued based on the foregoing representation. If upon investigation, it will be discovered that the facts are different, then this ruling shall be considered null and void.
>
> Very truly yours,
>
> SIXTO S ESQUIVAS IV
> Deputy Commissioner
> (Legal and Enforcement Group)

Based on the above-stated BIR Ruling DA 407-98 and the Exchange of Notes, petitioner now claims that its payment of the subject taxes was erroneous pursuant to Section 229 of the Tax Code, to wit:

> ***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 on 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. ***(Underscoring supplied.)***

We agree with petitioner.

Notably, there was an erroneous payment of the subject taxes by petitioner for the reason that said taxes are to be assumed by the Government of the Philippines through its executing agency, the NPC, in connection with Item 5(2) of the Exchange of Notes. As defined in ***Black's Law Dictionary, 6th Edition***, the word "assume" means "to take on, become bound, or put oneself in place of another as to an obligation or liability". As can be gleaned from the definition, the Government of the Philippines, through NPC, binds itself to shoulder the tax obligations and liabilities of petitioner. This finds support under the provision of Article VII (B) (1) of the Contract ***(Exhibit "I")*** executed between petitioner and NPC, to wit:

> Article VII (B) (1)
>
> "B. FOR ONSHORE PORTION
>
> 1.) CORPORATION (NPC) shall, subject to the provisions under the Contract Documents on Taxes, 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." ***(Exhibit "I-1")***

In addition, the testimony of petitioner's witness on the matter on which between the parties shall shoulder the subject taxes further strengthened petitioner's claim, thus:

xxx xxx xxx

Atty. Manalo: Now, based on the amendment to the contract between National Power Corporation and Mitsubishi Corporation, who will pay the taxes for the onshore portion of the Contract?

Witness: Under Article VII (B) of the original contract, the National Power Corporation shall pay the taxes for the onshore portion of the contract.

Atty. Manalo: I would like to request again for the submarking of Article VIII (B) of the original contract as Exhibit "I-1".

xxx xxx xxx

Therefore, the income tax and BPRT payments made by petitioner to respondent when such payments should have been made by the NPC, undoubtedly, put petitioner's case in the operation of Section 229 of the Tax Code as one involving erroneous payment.

A careful reading of the provisions of the Exchange of Notes will show that it is the intention of the two governments not to use the proceeds of the loan in the payment of all fiscal levies or taxes imposed by the Philippines. In view thereof, we believe that to deny petitioner's claim for refund would violate the covenant that the funded amount should not be subject to any taxes. This statement finds support under Item 8(a) of the Exchange of Notes, to wi:

> "8. The Government of the Republic of the Philippines will take necessary measures to ensure that:
>
> (a) The Loan be used properly and exclusively for the Project.

This is not the first time that this court has upheld the validity of the Exchange of Notes as a basis for the refund of erroneously collected taxes. In the case of ***P & N Corporation (Manila Branch Office) vs. Commissioner of Internal Revenue, CTA Case Nos. 4163 and 4293 (July 24, 1991)***, which involved a claim for refund of erroneously collected contractors' and withholding taxes, this court in granting the petition on the ground that the subject provision of the Exchange of Notes partakes the nature of a tax exemption, stated that:

> "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)***. 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, Section 12, 1973 Constitution, as amended). Therefore, having validly entered into a loan agreement through the exchange of notes, the terms therein necessarily govern the execution of the loan agreement. The contract, involved in this case which was entered into pursuant to the loan merely embodies the exemption provision in said exchange of notes."

Moreover, in ***Mitsubishi Corporation, Tokyu Construction Co., Ltd., A. M. Oreta and Co., Inc. and BF Corporation, Operating as MTOB Consortium, CTA Case No. 5757, January 15, 2002***, and in ***Mitsubishi Corporation, Tokyu Construction Co., Ltd., A. M. Oreta and Co., Inc. and BF Corporation, Operating as MTOB Consortium, CTA Case No. 6037, November 11, 2002***, this court, again pursuant to the Exchange of Notes, granted the claim of petitioners for the refund of unutilized creditable withholding value-added tax (VAT) in recognition of the validity of the Exchange of Notes. This court has noted that in these decisions, the subject claim for refund was based on the Notes-NAIA mentioned in BIR Ruling DA 407-98 in which herein petitioner was one of the claimants. Thus, in consideration of the above-stated pronouncements of this court affirming the validity of the Exchange of Notes as a valid ground for refund of erroneously paid taxes, this court finds no valid reason to disturb the wisdom of said rulings.

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. Pertinent portions of which read as follows:

> The foregoing provisions of the Exchange of Notes mean that the Japanese contractors or nationals engaged in OECF-funded projects in the Philippines shall not be required to shoulder all fiscal levies or taxes associated with the project. Instead, the taxes shall be shouldered and borne by the executing government agencies. Hence, for the comprehensive treatment of the tax implications arising therefrom, the following rulings are hereby promulgated:
>
> A) x x x
>
> B) INCOME TAX
>
> 1. Japanese firms or nationals operating as suppliers, contractors or consultants on and/or in connection with any income that may accrue from the supply of products and/or services to be provided under the Project Loan, shall file the prescribed income tax returns. Since the executing government agencies are mandated to assume the payment thereof under the Exchange of Notes, the said Japanese firms or nationals need not pay the taxes due thereunder.
>
> 2. The concerned Revenue District Officer shall, in turn, collect the said income taxes from the concerned executing government agencies.
>
> 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. ***(Underscoring supplied).***
>
> C) x x x

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 RMD 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.

Anent the second issue, this court finds that petitioner has properly presented sufficient evidence to substantiate its claim for erroneously paid income and branch profit remittance taxes for the fiscal year ended March 31, 1998.

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 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.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

(with Dissenting Opinion)
JUANITO C. CASTAÑEDA, JR.
Associate Judge

LOVELL R. BAUTISTA
Associate Judge

CERTIFICATION

I hereby certify that the above decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

MITSUBISHI CORPORATION - MANILA BRANCH,
Petitioner,

-versus-

C.T.A. CASE NO. 6139

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

DEC 17 2003

x - x

DISSENTING OPINION

With due respect to my colleagues, I beg to disagree with the majority's conclusion that petitioner is exempt from income tax and branch profit remittance tax pursuant to the Exchange of Notes between the Government of Japan and the Government of the Philippines *(Exhibit "J")* and BIR Ruling DA-407-98 dated September 7, 1998 *(Exhibit "K")* based on the following legal grounds:

1. There are constitutional grounds to prohibit the grant of tax exemption under such Exchange of Notes.
2. Section 32(B)(5) of the 1997 Tax Code provides that only treaties can grant income tax exemption.
3. The Exchange of Notes only provides for the assumption of tax liabilities by the Philippine Government. It does not provide for tax exemption.

4. BIR Ruling DA-407-98 dated September 7, 1998 does not entitle petitioner to a refund of income taxes paid by it.

Section 28(4), Article VI (Legislative Department) of the 1987 Constitution of the Philippines expressly provides: "No law granting any tax exemption shall be passed without the concurrence of a majority of all the Members of the Congress." The requirement of an absolutely majority of all the Members of Congress in the grant of tax exemption clearly manifests the intent of the framers of our Constitution that tax exemptions are not to be frivolously granted.

On the other hand, Section 21, Article VII (Executive Department) of the Constitution states: "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."

Related thereto is Section 32(B)(5) of the 1997 Tax Code, which provides:

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

In this regard, there is no showing that the Exchange of Notes involved here was approved by at least two-thirds of the entire Senate membership. Consequently, such Exchange of Notes cannot validly grant tax exemption and in fact, it did not.

As stated in the Majority Decision, records reveal that petitioner anchored its claim for refund on BIR Ruling No. DA-407-98 dated September 7, 1998 ***(Exhibit "K")***, issued by Deputy Commissioner Sixto S. Esquivias IV, interpreting Item 5, paragraph 2 of the aforementioned Exchange of Notes, which we herein quote for in pertinent part:

> x x x that item 7, paragraph 2 of Notes-NAIA states:
>
> "7 x x x
>
> (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/or services of Japanese nationals to be provided under the Loan.
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> It is likewise represented that on June 21, 1991, Mitsubishi entered into a contract with the National Power Corporation (NPC) for the supply of equipment and services, engineering, construction, testing and commissioning of equipment in connection with the Calaca II Project; that funding of the project is made through a grant from the Japanese Government through the OECF and pursuant to an Exchange of Notes dated June 11, 1987 (Notes-Calaca); that under the Notes-Calaca, a loan up to Y40,400,000,000.00 was extended expressly to implement

the Calaca II Project; that Item 5, paragraph 2 Notes-Calaca provides;

> "5 x x x
>
> (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.)***

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, x x x 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).

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.

The aforequoted ruling clearly states that the Exchange of Notes grants no tax exemption and merely provides that the Philippine Government assumes all tax liabilities. Hence, there is no violation 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)."

It must be noted that the Exchange of Notes is merely an agreement between the two governments (Philippines and Japan) involved. The Exchange of Notes is not a source of tax exemption as correctly pointed out by respondent in its ruling by stating that "there is no tax exemption to speak of because the said taxes shall be assumed by the Philippine Government." Undoubtedly, a tax assumption is not equivalent to tax exemption. The former arises from contract while the latter is granted by law through the legislative branch of the government. As a rule, "the claim of tax exemption must expressly be granted in a statute stated in a language too clear to be mistaken"(***Commissioner of Internal Revenue vs. Court of Appeals, 298 SCRA 83)***.

The Exchange of Notes is just a preparatory agreement or a mere understanding between the two governments in which the government of Japan will grant a loan in favor of the Philippine government to be used in the latter's economic development program. This is evident from the opening statements of the Exchange of Notes wherein it provided that:

"Excellency,

I have the honour to confirm the following understanding recently reached between the representatives of the Government of Japan and of the Government of the Republic of the Philippines concerning a Japanese loan to be extended with a view to promoting economic development efforts of the Republic of the Philippines: xxx" ***(p. 1, Exhibit "J")***

Clearly, the Exchange of Notes is not a "self-executing" agreement. This was the reason why the two loan agreements, Loan Agreement No. PH-P76 ***(Exhibit "O")*** dated September 25, 1987 and Loan Agreement No. PH-P141 ***(Exhibit "P")*** dated December 20, 1994, were executed providing the Philippine government enough funds to implement the Calaca II Project. Accordingly, in order to realize this project, the NPC, the executing agency of the Philippine government entered into a contract with herein petitioner and in said Contract the provision of Article VIII (B) (1) ***(Exhibit "I")*** was included in order to carry-out the undertaking assumed by the Philippine government (through the NPC), to wit:

Article VIII (B) (1)

"B. FOR ONSHORE PORTION

1.) CORPORATION (NPC) shall, subject to the provisions under the Contract Documents on Taxes, 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."
(Exhibit "I-1")

This provision not only realized the intent of the two governments under Item 5, paragraph 2 of the Exchange of Notes but it also recognized the covenant of the two governments not to use the proceeds of the loan in the payment of all fiscal levies or taxes imposed by the Philippines. This statement finds support under Item 8(a) of the Exchange of Notes, to wit:

> "8. The Government of the Republic of the Philippines will take necessary measures to ensure that:
>
> (a) The Loan be used properly and exclusively for the Project, x x x"

However, despite the provision in the Contract that NPC shall assume the tax liabilities of petitioner, the latter still made payments of the subject taxes to respondent. And now, petitioner, believing that it has made erroneous payments of the subject taxes, is before us invoking the provision of Section 229 in relation to Section 204 of the Tax Code.

The petition is without merit.

Petitioner has no basis in law. The provision of Section 229 is not applicable to petitioner, to wit:

> ***Section 229. Recovery of Tax Erroneously or Illegally Collected.*** - <u>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</u>; 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 on 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. ***(Underscoring supplied)***

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.

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.

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.

However, petitioner remedy, if any, is to seek a cash refund from NPC for the equivalent amount of the income taxes and branch profit remittance taxes it paid to the BIR. This remedy is recognized by the respondent himself when he issued ***Revenue Memorandum Circular (RMC) No. 32-99, as amended by Revenue Memorandum Circular 42-99 dated June 2, 1999***, which provides that "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.

International comity may not be invoked to evade our tax laws. Thus, the Supreme Court held:

> "It is too settled a rule in this jurisdiction, as to dispense with the need for citations, that laws granting exemption from tax are construed *strictissimi juris* against the taxpayer and liberally in favor of the taxing power. Taxation is the rule and exemption is the exception. The burden of proof rests upon the party claiming exemption to prove that it is in fact covered by the exemption so claimed, which onus petitioners have failed to discharge. Significantly, private respondents are not even among the entities which, under Section 29(b)(7)(A) of the tax code, are entitled to exemption and which should indispensably be the party in interest in this case.
>
> 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." ***Commissioner of Internal Revenue vs. Mitsubishi Metal Corporation, G.R. No. 54908, January 22, 1990, 181 SCRA 82.***

Tax exemptions must be strictly construed such that the exemption will not be held to be conferred unless the terms under which it is granted clearly and distinctly show that such was the intention of the parties (***Philippine Acetylene Co., Inc. v. Commissioner of Internal Revenue, G.R. No. L-19707, Aug.17,1967; Manila Electric Company vs. Vera, etc., G.R. No. L-29987, Oct. 22,1975; Surigao Consolidated Mining Co., Inc. v. Collector of Internal Revenue, et al., G.R. No. L-14878, December 26, 1963, all cited in Aban, Law of Basic Taxation of the Philippines, p. 119***). Tax exemptions are not presumed (***Lealda Electric Co., Inc. v. Collector of Internal Revenue, G.R. No. L-16428, April 30, 1963***). Tax 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 (***Commissioner of Internal Revenue v. S.C. Johnson and Son, Inc., 309 SCRA 87 [1999]***).

In the light of the foregoing, we cannot conclude that the Exchange of Notes grants tax exemption to petitioner. Hence, petitioner's claim for refund should be denied for lack of merit.

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