REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

EN BANC

MIRANT SUAL CORPORATION (formerly: Southern Energy Pangasinan, Inc.),
Petitioner,

C.T.A. E.B. NO. 144
(C.T.A. CASE NO. 6388)

Present:

ACOSTA, *P.J.*
CASTAÑEDA, JR.,
BAUTISTA,
UY,
CASANOVA, *and*
PALANCA-ENRIQUEZ, *JJ.*

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

JAN 1 5 2007 Apolinario

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D E C I S I O N

UY, J.:

This is a Petition for Review before the Court of Tax Appeals *En Banc* filed on December 23, 2005 under Republic Act No. 9282, seeking a review of the Decision and Resolution by the Second Division of this Court (Court in Division) in CTA Case No. 6388, entitled "Mirant Sual Corporation (formerly: Southern Energy Pangasinan, Inc.) vs. Commissioner of Internal Revenue", to wit:

1) Decision promulgated on August 22, 2005 partially granting petitioner's claim for refund or issuance of tax credit certificate in its favor in the amount of THIRTY ONE THOUSAND TWO HUNDRED EIGHTY ONE AND 36/100 PESOS (P31,281.36) representing excess remittance of final withholding tax in behalf of Aggreko; and

2) Resolution promulgated on November 14, 2005 denying petitioner's Motion for Reconsideration of the aforesaid Decision for lack of merit.

THE FACTS

The factual antecedents of the case are not in dispute.

Petitioner Mirant Sual Corporation (MSC), formerly: Southern Energy Pangasinan, Inc., is a corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines with principal office located at Barangay Pangascasan, Sual, Pangasinan.

Respondent is the duly appointed Commissioner of Internal Revenue (CIR) vested with the authority to act as such, including, inter alia, the power to decide, approve and grant claims for refunds or tax credits of erroneously paid internal revenue taxes as provided by law with office address at BIR National Office Building, Agham Road, Diliman, Quezon City, where he may be served summons and other court processes.

Petitioner is principally engaged in the business of power generation and the subsequent sale thereof to the National Power Corporation (NPC) under a Build, Operate Transfer (BOT) Scheme.

Petitioner MSC is originally registered with the Securities and Exchange Commission (SEC) under the name Pangasinan Electric Corporation with SEC Registration No. AS094-2935.

Pangasinan Electric Corporation was registered with the Bureau of Internal Revenue (BIR), RDO 5, Alaminos Pangasinan as a withholding agent on January 22, 1996 with Taxpayer Identification Number (TIN) 003-841-103.

On August 17, 1999, the corporate name Pangasinan Electric Corporation was officially changed to Southern Energy Pangasinan, Incorporated (SEPI) upon approval by the SEC and issuance of the Certificate of Filing of Amended Articles of Incorporation dated August 17, 1999 with SEC Registration Number ASO94-2935.

SEPI was registered with the BIR-RDO 5, Alaminos, Pangasinan, as a withholding tax agent with TIN 003-841-103.

Finally, on June 28, 2001, petitioner adopted the corporate name Mirant Sual Corporation (MSC) upon the approval by the SEC and issuance of the Certificate of Filing of Amended Articles of Incorporation dated June 28, 2001 with SEC Registration Number AS094-002935.

Petitioner under its new corporate name, MSC, is registered with the BIR-RDO 5, Alaminos, Pangasinan, as a withholding tax agent with TIN 003-841-103.

In the course of its business, petitioner engaged the services of Engica, a foreign corporation established in the United Kingdom, for the installation, configuration and customization of the Q4 system (a computer inventory system), which was purchased by the petitioner from the latter. In view of the fact that Engica is a foreign corporation, petitioner withheld thirty-two (32%) percent final taxes on its income payment to the former in the aggregate amount of P6,495,395.85 and remitted the same to the BIR. After its postaudit, however, petitioner is of the opinion that Engica is a resident foreign corporation for income tax purposes by virtue of the RP-UK Tax Treaty; thus, the income payments to the latter should have only been subjected to a five (5%) percent expanded/creditable withholding tax, pursuant to Section 2.57.2 of Revenue Regulations (RR) No. 2-98, and not to thirty-two (32%) percent final withholding tax. Consequently, petitioner withheld and remitted anew the five (5%) percent expanded/creditable withholding tax and now seeking for the refund of its previously remitted amount of P6,495,395.85.

Likewise, petitioner rented out generators and other equipments from another foreign corporation under the name of Aggreko, the latter having its head office in Singapore. Under the same pretext, petitioner withheld thirty-two (32%) percent final withholding tax on income payments to Aggreko in the amount of P40,857.28. However, it is petitioner's belief that rental payments to Aggreko should only be subject to the seven and a half (7.5%) percent pursuant to Section 28 (B)(4) of the National Internal Revenue Code (NIRC) of 1997. Hence, it was petitioner's contention that it erroneously overpaid the amount of P31,281.35.

On January 30, 2001 and under its former name SEPI, petitioner filed with the BIR-RDO 5 its/the Annual Information Return of Income Taxes Withheld on Compensation and Final Withholding Taxes (BIR Form No. 1604-CF) with the attached Alpha list of Payees subject to final withholding tax for calendar year 2000.

On February 6, 2002, petitioner filed an administrative claim for refund with the Bureau of Internal Revenue (BIR) in the total amount of

P6,526,677.20 (P6,495,395.85 + P31,281.35), representing erroneously paid final withholding tax of petitioner for various months of taxable year 2000.

On February 8, 2002, the Petition for Review for the recovery of its erroneously paid final withholding tax was filed with the Court in Division.

On August 22, 2005, the Court in Division rendered its assailed Decision partially granting petitioner's claim for refund or issuance of tax credit certificate in its favor only in the amount of THIRTY ONE THOUSAND TWO HUNDRED EIGHTY ONE AND 36/100 PESOS (P31,281.36) representing excess remittance of final withholding tax in behalf of Aggreko.

Finding no valid or cogent reason to either alter or modify the assailed Decision, the Court in Division denied petitioner's Motion for Reconsideration thereof in the Resolution dated November 14, 2005.

Hence, this recourse before the Court *En Banc* praying that the assailed Decision and Resolution of the Court in Division promulgated on August 22, 2005 and November 14, 2005, respectively, be reversed and a new one be issued ordering respondent to refund or issue a tax credit certificate in favor of petitioner the amount of SIX MILLION FIVE HUNDRED THIRTY SIX THOUSAND TWO HUNDRED FIFTY THREE AND 13/100 PESOS (P6,536,253.13).

THE ISSUES

The issues being raised by petitioner in the instant petition for review are as follows:

> 1. Whether or not Engica is a resident foreign corporation for Philippine income tax purposes;

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2. Whether or not in a claim for refund of erroneously paid final withholding tax, it is required that the withholding agent should prove that the income recipient has filed its tax return and paid its income tax in the Philippines;

3. Whether or not petitioner is the proper party to file the claim for refund of erroneously paid withholding tax;

4. Whether or not petitioner has to file an application for a tax treaty relief with the International Tax Affairs Division of the Bureau of Internal Revenue; and

5. Whether or not the income payments to Engica are subject to the 5% expanded withholding tax.

Respondent filed his "Comment (Re: Petition for Review)" on February 9, 2006 and prayed for the dismissal of the present petition for lack of merit.

THE COURT EN BANC'S RULING

We find no merit in the petition.

A careful and closer look at the arguments set forth by the petitioner in the instant petition would readily reveal that the grounds relied upon and the matters raised herein are mere restatements of petitioner's previous arguments raised before the Court in Division which had already been exhaustively discussed and passed upon in its assailed Decision and Resolution promulgated on August 22, 2005 and November 14, 2005, respectively.

Be that as it may, with the end view of further clarifying the matter, there is no doubt that under Section 28 (B)(1) of the NIRC of 1997, a non-resident corporation is liable to pay a tax equal to thirty two (32%) percent of the gross income received during each taxable year from all sources within the Philippines beginning January 1, 2000. To quote:

"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) and (d): Provided, that effective January 1, 1998, the rate of income tax shall be thirty-three percent (33%), and effective January 1, 2000 and thereafter, the rate shall be thirty-two percent (32%)." *(Underscoring Ours)*

Material to the resolution of the controversy in this case is the determination of what is a resident foreign corporation and a non-resident foreign corporation. Under Section 22 (H) and (I) of the NIRC of 1997, the aforesaid terms are distinguished from each other in the following manner:

"SEC. 22. Definitions. – When used in this Title –

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(H) The term "resident foreign corporation" applies to a foreign corporation engaged in trade or business within the Philippines.

(I) The term "nonresident foreign corporation" applies to a foreign corporation not engaged in trade or business within the Philippines."

Correspondingly, a definitive classification of Engica's tax personality, either as a resident or nonresident foreign corporation, will resolve petitioner's instant claim for refund.

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As to whether or not Engica was "doing business" in the Philippines as to be considered a "resident foreign corporation", it is worthy to mention that the phrase "doing business" has been interpreted by the Supreme Court in this fashion:

> "No general rule or governing principle can be laid down as to what constitutes 'doing' or engaging in' or 'transacting' business. Indeed, each case must be judged in the light of its peculiar environmental circumstances. The true test, however, seems to be whether the foreign corporation is continuing the body or substance of the business or enterprise for which it was organized or whether it has substantially retired from it and turned it over to another (Traction Cos. vs. Collectors of Internal Revenue [C.C.A., Ohio], 223 F., 984, 987). The term implies a continuity of commercial dealings and arrangements, and contemplates, to that extent, the performance of acts or works or the exercise of some of the functions normally incident to, and in progressive prosecution of, the purpose and object of its organization."[1] *(Underscoring Ours)*

Applying the foregoing in the case at bench, in order that Engica, a foreign corporation, may be regarded as doing business in the Philippines, there must be continuity of conduct and intention to establish a continuous business, such as the appointment of a local agent, and not one of a temporary character. Failure to establish such conduct and intention are fatal to petitioner's claim/allegation that Engica is a resident foreign corporation.

As correctly determined by the Court in Division, notwithstanding the fact that Engica has created a permanent establishment by virtue of the RP-UK Tax Treaty, the aforesaid treaty does not automatically convert the foreign corporation into a resident corporation under our tax jurisdiction but merely speaks of how it should be taxed.

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[1] The Mentholatum Co., Inc., et al. vs. Anacleto Mangaliman, et al., 72 Phil. 524 (1941).

To emphasize further, it was likewise declared that "Engica has no license and certificate to transact business in the Philippines and has no office or place of business in the Philippines to be classified as a resident foreign corporation".[2]

Moreover, the assailed Decision already elaborated the matter in this wise:

> "First, if We go along with the position of herein petitioner that Engica is a resident foreign corporation, then it must follow that Engica should be subjected to income tax at the rate of 32% on its net taxable income, to wit:
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> > 'Sec. 28. Rates of Income Tax on Foreign Corporations. —
> >
> > (A) Tax on Resident Foreign Corporations. —
> >
> > > (1) In General — Except as otherwise provided in this Code, a corporation organized, authorized, or existing under the laws of any foreign country, engaged in trade or business within the Philippines, shall be subject to an income tax equivalent to thirty-five percent (35%) of the taxable income derived in the preceding taxable year from all sources within the Philippines: Provided, That effective January 1, 1998, the rate of income tax shall be thirty-four percent (34%); xxx and effective <u>January 1, 2000 and thereafter, the rate shall be thirty-two percent (32%)</u>.' (Emphasis supplied)
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> Further, Engica should also be required to file annual tax returns, as like any other domestic corporations, viz:
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> > 'Sec. 52. Corporation Returns. —
> >
> > (A) Requirements. — Every corporation subject to the tax herein imposed, except foreign corporation not engaged in trade or business in the Philippines, shall render, in duplicate, a true and accurate quarterly income tax return and final or adjustment return in accordance with the provisions of Chapter XII of this

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2 Decision dated August 22, 2005, CTA Case No. 6388, p.16; Rollo, p.24.

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> Title. The return shall be filed by the president, vice-president, or other principal officer, and shall be sworn to by such officer and by the treasurer or assistant treasurer.'
>
> To these requirements, petitioner failed to show that Engica, allegedly a resident foreign corporation, has filed its tax return and paid its income tax in the Philippines. Thus, it would be inequitable for the government to grant the refund to petitioner absent any corresponding payment of tax from the taxpayer. It will be the height of absurdity to allow the refund where in fact Engica has never filed its proper income tax as a resident foreign corporation, and, for all intents and purposes, Engica could have already benefited from the previously withheld final tax by applying the same as a tax credit in the United Kingdom.
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> Secondly, if Engica is a resident foreign corporation, then it has the capacity to file, on its own, the instant claim for refund. Engica, in the instant case, is the proper party to claim the refund for it is the income earner from whose account the tax was withheld, on the other hand, petitioner only withheld the final tax. Though, jurisprudence suggests that withholding agents are allowed to claim for refund on behalf of the payee, the same does not apply in the instant case, since what were involved in those long line of cases, were foreign corporations not doing business in the Philippines, and in the instant case Engica, as alleged by petitioner, is a resident foreign corporation doing business in the Philippines. Moreover, Engica never authorized nor designated petitioner to file, on its behalf, the instant refund.'[3]

Taken collectively, Engica cannot be considered a resident foreign corporation contemplated by law. There was no showing that it continued its business operations in the Philippines. Consequently, Engica shall be considered as a nonresident foreign corporation subject to the final withholding tax pursuant to Section 28 (B)(1) of the NIRC of 1997. In other words, petitioner failed to present any clear and convincing proof that Engica is indeed a resident foreign corporation which could have allowed petitioner's entire claim for refund or issuance of a tax credit certificate representing excess remittance of final withholding tax.

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3 Ibid, pp.11-13; Rollo, pp.19-21.

The burden of proof is upon him who claims the exemptions in his favor and he must be able to justify his claim by the clearest grant of the organic or statute law.[4] This is consistent with the well-established principle that tax refunds are in the nature of a tax exemption and should be construed strictissimi juris against the taxpayer.[5]

To reiterate, the fact that Engica created a permanent establishment under the RP-UK Tax Treaty, this circumstance did not convert Engica into a resident foreign corporation for the purpose of rendering the final withholding tax withheld by petitioner improper, neither did it result in subjecting Engica to a lower tax rate of 5% expanded/creditable withholding tax under Revenue Regulations No. 2-98.

In the light of the foregoing considerations, We find no reversible error committed by the Court in Division when it rendered the assailed Decision dated August 22, 2005, and Resolution dated November 14, 2005.

WHEREFORE, premises considered, the instant petition is hereby **DENIED DUE COURSE**, and, accordingly, **DISMISSED** for lack of merit.

SO ORDERED.

ERLINDA P. UY
Associate Justice

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4 China Banking Corporation vs. Court of Appeals, 403 SCRA 634 (2003).

5 Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc. and Court of Appeals, 309 SCRA 87(1999); Commissioner of Internal Revenue vs. Tokyo Shipping Co., Ltd., 244 SCRA 332 (1995); Commissioner of Internal Revenue vs. Procter and Gamble Philippine Manufacturing Corporation and the Court of Tax Appeals, 204 SCRA 377 (1991).

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

CAESAR A. CASANOVA
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution, it is hereby certified that the conclusions in the above decision were reached in consultation before the case was assigned to the writer of the opinion of the Court *En Banc*.

ERNESTO D. ACOSTA
Presiding Justice