REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PROCTER & GAMBLE PHILIPPINE
MANUFACTURING CORPORATION,
Petitioner,

- versus - C.T.A. CASE NO. 2437

COMMISSIONER OF INTERNAL
REVENUE,
Respondent. 1/4/77

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D E C I S I O N

In this petition for the review of a decision of respondent Commissioner of Internal Revenue, the decisive question presented by petitioner Procter & Gamble Philippine Manufacturing Corporation is whether or not it is under legal obligation to deduct and withhold from the freight payments remitted by it to non-resident foreign shipping corporations the income tax due thereon, file the requisite withholding returns and pay the tax withheld to the Bureau of Internal Revenue.

The following are the pertinent facts stipulated and submitted by the parties:

(1) That petitioner is a corporation organized and existing under the laws of the Philippines, with principal office at Sarmiento

Building, Ayala Avenue, Makati, Rizal, while the respondent is the government official duly appointed and authorized to collect national internal revenue taxes under the National Internal Revenue Code, and to enforce laws pertaining to such taxes;

(2) That petitioner is engaged in the business, among others, of exporting to foreign ports bulk copra and other copra products;

(3) That petitioner does not own ocean-going vessels through which it can ship to foreign ports its exports of bulk of copra and other copra products;

(4) That during its fiscal year ended. June 30, 1966, for purposes of shipping its copra exports to foreign ports, petitioner, as charterer, entered into charter parties with foreign shipowners. Attached hereto and made an integral part of this stipulation of facts are a copy of each eight (8) charter parties entered into by petitioner during the period indicated above, marked as Annexes "A" to "H", inclusive;

(5) That the foreign shipowners with whom petitioner entered into the charter parties are nonresident foreign corporations, but pursuant to the terms of the charter parties, their vessels, which were the subjects of the charter parties, proceeded to and touched Philippine ports for purposes of losing petitioner's copra exports;

(6) That after availing of the use of the chartered vessels pursuant to the charter parties, petitioner made freight payments to the foreign shipowners as stated and itemized in the attached schedule of payments (p. 36, BIR Records), marked as Annex "I", and made as an integral part hereof;

(7) That in remitting the freight payments itemized in Annex "I" and mentioned in the next preceding paragraph to the foreign shipowners, petitioner did not deduct and withhold any tax therefrom;

(8) That on the basis of Confidential Information No. 564, dated October 19, 1970, respondent caused the examination of petitioner's books of accounts for the year ended June 30, 1966, and, after his examiners submitted their report for examination, dated July 9, 1971 (pp. 37-41, BIR records), respondent issued to petitioner an assessment letter, dated October 15, 1971, demanding from petitioner the payment of the total amount of ₱2,021,995.69 as deficiency withholding income tax, inclusive of interest and 25% surcharge (pp. 51-52, BIR records).

(9) That for the years 1965 and 1966, in compliance with the then provision of Section 54, in relation to Section 53(e) of the Tax Code, petitioner filed with the office of the respondent the corresponding annual returns of income tax withheld and paid at source covering payments of Philippine-source income to a nonresident foreign corporation other than the foreign shipowners with whom petitioner entered into the charter parties. A copy each of the said returns are hereto attached as Annex "J" and Annex "K";

(10) That in a letter dated November 10, 1971 and filed with the office of respondent on November 12, 1971, petitioner, through its auditors, protested the assessment dated October 15, 1971 (pp. 60-66, BIR records);

(11) That on September 4, 1972, petitioner, through its auditors, received respondent's letter, dated September 15, 1972, denying petitioner's protest and reiterating his (respondent's) demand for the payment of the deficiency tax, the amount of which has increased to ₱2,315,164.36 by the addition of additional interests and surcharges;

(12) That the basis of the assessment is petitioner's failure to withhold and pay 30% withholding tax on the amount of ₱4,713,278.00 which it remitted to the foreign ship-owners as freight payments for the use of the latter's vessels in loading petitioner's copra cargoes to various foreign ports;

(13) That the issues in this case to be decided by this Honorable Court are:

(a) Whether or not petitioner was under obligation to withhold and pay the income tax from the freight payments to the foreign shipowners;

(b) Assuming that the answer to (a) is in the affirmative, whether or not the right of respondent to assess has prescribed; and

(c) Whether or not petitioner is subject to the 25% surcharge.

(14) That the parties reserve the right to introduce additional evidence not covered by this stipulation of facts, to support their respective contentions.

To begin with, it should be stressed, as stated in paragraph 5 of the "Stipulation of Facts", that the foreign shipowners with whom petitioner entered into the charter parties are non-resident foreign corporations. As non-resident foreign corporations, they are thus foreign corporations not engaged in trade or business within the Philippines and not having any office or place of business therein. (Sec. 84(h), Tax Code). They are therefore taxable on income from all sources within the Philippines, as interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical or casual gains, profits and income and capital gains, and the tax is equal to thirty (now thirty-five) per centum of such amount, under Section 24(b)(1) of the Revenue Code. Accordingly, the foreign shipowners with whom petitioner entered into the charter parties being non-resident foreign corporations, their taxable income for purposes of our income tax law consists of their gross income from all sources within the Philippines. (N.V. Reederij "Amsterdam" and Royal Interocean Lines vs. Commissioner of Internal Revenue, CTA Case No. 1996, Dec. 1, 1976.)

In line with the foregoing, this Court thus ruled that the formula of general apportionment set out in Section 163, Revenue Regulations No. 2, is not applicable to non-resident foreign steamship companies not engaged in business in the Philippines and not having any office or place of business herein. Said this Court in N.V. Reederij "Amsterdam" and Royal Interocean Lines vs. Commissioner of Internal Revenue, supra, where the factual setting is similar to that in the case at bar, in the following words:

Back to the statute. Stated by way of paraphrase, Section 37(e) deals with the determination of the net income taxable in the Philippines where income has been derived from sources partly within and partly without the Philippines. The net income may first be computed by deducting the expenses, losses, or other deductions apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some items or class of gross income; and the portion of such net income attributable to sources within the Philippines may be determined by processes or formulas of general apportionment prescribed by the Secretary of Finance. And apropos of items of gross income from sources partly within and partly without the Philippines, the law considers as one of them the gross receipts of foreign steamship companies whose vessels touch ports of the Philippines. For a foreign shipping corporation whose vessels touch Philippine ports, the formula of general apportionment set out in Section 163, Revenue Regulations No. 2, applies.

It must be stressed, however, that Section 37(e) of the Code, as implemented by Section 163 of the Regulations, provides the rule for the determination of the net income taxable in the Philippines of foreign steamship company doing business in the Philippines. To assure that non-resident foreign steamship companies not engaged in business in the Philippines and not having any office or place of business herein are not covered therein, the regulations explicitly and clearly provide that "the net income of a foreign steamship company doing business in or from this country is ascertained", under the formula contained therein, "for the purpose of the income tax." The reason is easily discernible. As stated above, the taxable income of non-resident foreign corporation consists of its gross income from all sources within the Philippines. Accordingly, a foreign steamship corporation derives income partly from sources within and partly from sources without the Philippines if it is carrying on a business of transportation service between points in the Philippines and outside the Philippines. (Vol. 3, 1965, Federal Taxes, Par. 16,389). Only then does Section 37(e) of the Tax Code, as implemented by Section 163 of the Regulations, apply in computing net income subject to tax. There is no basis therefore for an assertion "that Section 37(e) does not distinguish between a foreign corporation engaged in business in the Philippines and a foreign corporation not engaged in business in the Philippines."

Petitioner's submission that it has no obligation to withhold the income tax on the freight payments it made to foreign steamship companies, not engaged in business in the Philippines and not having any office or place of business herein, because the law and regulation then applicable treated such foreign steamship companies as a special class of foreign taxpayers in the sense that they were required to file their own income tax returns and to pay the tax on their Philippine-source income, instead of being subjected to the withholding tax-at-source provisions of Sections 53 and 54 of the Tax Code, is therefore positively without merit.

The law requires that every individual, person or corporation, in whatever capacity acting, having the control, custody, disposal or payment of compensation or other fixed or determinable annual or periodical or casual gains, profits and income of foreign corporations subject to income tax not engaged in trade or business within the Philippines, to deduct and withhold from such income the tax due thereon, file the requisite withholding return and pay the tax withheld to the Bureau of Internal Revenue. (Secs. 53, 54, Tax Code; Sec. 205, Rev. Regs. No. 2). We quote the pertinent portions of law:

> "Sec. 54.- Payment of corporation income tax at source.- In the case of foreign corporations subject to taxation under this Title not engaged in trade or business within the Philippines and not having any office or place of business therein, there shall be deducted and withheld at the source in the same manner and upon the same items as is provided in section fifty-three a tax equal to thirty *per centum* thereof, and such tax shall be returned and paid in the same manner and subject to the same conditions as provided in that section: x x x."

> "Sec. 53(b).- Nonresident aliens.- All persons, corporations and general co-partnerships (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, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits and income of any nonresident 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 (a) of this Section) deduct and withhold from such annual or periodical gains, profits and income a tax equal to twenty (now 30%) 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 corporation 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 by 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 a matter of fact, Section 53(c) of the Tax Code makes the withholding agent personally liable for the income tax withheld under Section 54 of the same Code. Said section provides:

"Sec. 53(c).- Return and payment.- Every person required to deduct and withhold any tax under this section shall make return thereof, in duplicate, on or before the fifteenth day of April of each year, and, on or before the time fixed by law for the payment of the tax, shall pay the amount withheld to the officer of the Government of the Philippines authorized to receive it. Every such person is made personally liable for such tax, and is indemnified against the claims and demands of any persons for the amount of any payments made in accordance with the provisions of this section. (As amended by Section 9, Republic Act No. 2343)"

In this connection, the Supreme Court said and we quote:

The law sets no condition for the personal liability of the withholding agent to attach. The reason is to compel the withholding agent to withhold the tax under all circumstances. In effect, the responsibility for the collection of the tax as well as the payment thereof is concentrated upon the person over whom the Government has jurisdiction. Thus, the withholding agent is constituted the agent of both the Government and the taxpayer. With respect to the collection and/or withholding of the tax, he is the Government's agent. In regard to the filing of the necessary income tax return and the payment of the tax to the Government, he is the agent of the taxpayer. The withholding agent, therefore, is no ordinary government agent especially because under Section 53(c) he is held personally liable for the tax he is duty bound to withhold, whereas, the Commissioner of Internal Revenue and his deputies are not made liable by law.

x x x x

'In case of doubt, a withholding agent may always protect himself by withholding the tax due, and promptly causing a query to be addressed to the Commissioner of Internal Revenue for the determination whether or not the income paid to an individual is not subject to withholding.

In case the Commissioner of Internal Revenue decides that the income paid to an individual is not subject to withholding the withholding agent may thereupon remit the amount of tax withheld.' (2nd par., Sec. 200, Income Tax Regulations)

"The section above-quoted (Sec. 200, Income Tax Regulations) relaxes the application of the stringent provisions of Section 53 of the Tax Code. Accordingly, it grants exemption from tax liability, and in so doing, it lays down steps to be taken by the withholding agent, namely: (1) that he withholds the tax due; (2) that he promptly addresses a query to the Commissioner of Internal Revenue for determination whether or not the income paid to an individual is subject to withholding; and (3) that the Commissioner of Internal Revenue decides that such income is not subject to withholding. Strict observance of said steps is required of a withholding agent before he could be released from liability. Generally, the law frowns upon exemption from taxation, hence, an exempting provision should be construed strictissimi juris." (RESOLUTION, The Philippine Guaranty Co. vs. The Commissioner of Internal Revenue and The Court of Tax Appeals, G.R. No. L-22074, September 6, 1965; 15 SCRA 1).

What then is the rationale of the withholding of the corresponding income tax at source of the income required under Sections 53 and 54 of the Revenue Code? This is important because, as made explicit by the Supreme Court in the case of British Traders' Insurance Co., Ltd. vs. Commissioner of Internal Revenue, G.R. No. L-20501, April 30, 1965, 13 SCRA 719:

"The taxability of a foreign corporation's income depends upon the locus of the activity, property or service giving rise thereto. x x x x Stated otherwise, the flow of wealth proceeded from, and occurred within, Philippine territory, enjoying therein the protection accorded by our Government. Such flow of wealth should, in consideration for the protection, share the burden of supporting the Government. x x x Precisely, our legislators adopted the administrative device in Sections 53 and 54 - withholding of the corresponding income tax at source of the income - to insure collection of whatever tax may be due on income earned in the Philippines by those who are not doing business in the Philippines and have no office or agent here. The fact that a foreign corporation does not engage in business here and has no office or agent is the very reason why its income is subject to withholding tax. (Sec. 54, National Internal Revenue Code) (British Traders' Insurance Col., Ltd. vs. Commissioner of Internal Revenue, G.R. No. L-20501, April 30, 1965, 13 SCRA 719).

It appearing (1) that the foreign shipowners to whom petitioner remitted its freight payments are non-resident foreign corporations not engaged in business in the Philippines and not having any office or place of business herein; (2) that such freight payments are fixed or determinable annual and/or periodical income as shown by the bank notes register or schedule of payments (par. 6, Stipulation of Facts, Annex "I", Exh. "2", p. 36, BIR rec.); and (3) that the said freight payments were under the control, custody, disposal or payment of Procter & Gamble Philippine Manufacturing Co., petitioner is under legal obligation, as withholding agent of the Government, to deduct and withhold from such freight payments the income tax due thereon, file the requisite withholding returns and pay the tax withheld to the Bureau of Internal Revenue, pursuant to the provisions of Sections 53 and 54 of the Revenue Code.

The problem of prescription now comes in. The Supreme Court, in the case of Aznar vs. Court of Tax Appeals, L-20569, August 23, 1974, 58 SCRA 519, construing Sections 331 and 332 of the Revenue Code, held that the ten-year period provided in Section 332 applies to three different situations, i.e., (1) false return, (2) fraudulent return with intent to evade tax, and (3) failure to file a return, while the five-year period prescribed in Section 331 should apply only to "normal circumstances." We quote from said decision:

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"To our mind we can dispense with these controversial arguments on facts, although we do not deny that the findings of facts by the Court of Tax Appeals, supported as they are by very substantial evidence, carry great weight, by resorting to a proper interpretation of Section 332 of the NIRC. We believe that the proper and reasonable interpretation of said provision should be that in the three different cases of (1) false return, (2) fraudulent return with intent to evade tax, (3) failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the (1) falsity, (2) fraud, (3) omission. Our stand that the law should be interpreted to mean a separation of the three different situations of false return, fraudulent return with intent to evade tax, and failure to file a return is strengthened immeasurably by the last portion of the provision which segregates the situations into three different classes, namely - "falsity", "fraud" and "omission". That there is a difference between "false return" and "fraudulent return" cannot be denied. While the first merely implies deviation from the truth, whether intentional or not, the second implies intentional deceitful entry with intent to evade the taxes due."

The construction given in the Aznar decision that the "false or fraudulent return with intent to evade tax" appearing in Section 332 of the Revenue Code contemplates of two different situations, that of "false" return without intent to evade tax and the other that of a "fraudulent" return with intent to evade tax, in the opinion of former Presiding Judge Roman M. Umali expressed in the case of Barcelona vs. Commissioner of Internal Revenue, CTA Case No. 1806, December 29, 1975, is not justified by the wording of the law. This is the way it was rationalized by the former Presiding Judge of this Court:

> Obviously, the phrase "with intent to evade tax" is intended to qualify "false" return rather than "fraudulent" return. There is no need to qualify the term "fraudulent return" by the phrase "with intent to evade tax." When a return is established to have been filed fraudulently, there can be no other conclusion than that the taxpayer intended to evade tax. It is well nigh impossible to conceive of a person filing a fraudulent income tax return without intent to evade tax. It is believed, therefore, that in referring to a "false or fraudulent return with intent to evade tax" the law intends to refer only to cases involving fraudulent returns, otherwise, Section 331 providing for the five year prescriptive period in non-fraud cases would be rendered nugatory.

However, considering that the Court of Tax Appeals is bound by the decisions of the Supreme Court, in endeavoring to apply the ruling in the Aznar case as faithfully as it is possible, this Court, in the Barcelona case , supra, explained that:

> The Aznar decision classifies false returns or incorrect returns, not involving fraud, into two classes. The first refers to false or incorrect returns filed under "normal circumstances" to which the five-year period provided in Section 331 applies, and the second refers to false or incorrect returns to which the ten-year period provided in Section 332 is applicable. To quote from the Aznar decision:
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> > "The ordinary period of prescription of 5 years within which to assess tax liabilities under Sec. 331 of the NIRC should be applicable to normal circumstances, but whenever the government is placed at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities due to false returns, fraudulent return intended to evade payment of tax or failure to file returns, the period of ten years provided for in Sec. 332(a) NIRC, from the time of the discovery of the falsity, fraud or omission even seems to be inadequate and should be the one enforced."
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> The Aznar decision does not define nor has it attempted to explain the meaning of returns filed under "normal circumstances" to which the five-year period applies. It mentions, however, the cases to which the ten year period are applicable. It is said that the ten-year period applies "whenever the government is placed at a disadvantage so as to prevent its lawful agents from proper assessment of tax liabilities due to false returns."

In the case at bar, just like in the Barcelona case, no attempt has been made by petitioner to hide the freight payments remitted by it to foreign shipowners. The failure to include the freight payments in question was due to its belief that the same were not taxable. According to petitioner, the amounts paid do not constitute income from Philippine sources and hence not subject to Philippine income tax since these remittances to the non-resident foreign shipowners were not in payment of freight but as compensation for the charter of their vessels under charter party agreements executed and consummated abroad. It is alleged that under the charter party, the foreign shipowners were divested of control and possession over the vessels as the same were transferred to petitioner. And if the said freight payments were taxable, petitioner submits that there is no obligation on its part to withhold the income tax on such payments as pursuant to Section 163 of the Income Tax Regulations, the demand should have been directed upon the foreign shipowners.

That Section 163 is applicable for purposes of taxing the freight payments received by the foreign shipowners was also shared by respondent's examiners. (Exhs. "B", "B-1"; pp. 37-41, BIR rec.)

And Section 163, the authority relied upon by the examiners in recommending the issuance of the deficiency withholding tax assessment, which recommendation was approved by respondent, imposes the obligation to file the return and to pay the tax on the foreign steamship companies.

Having acted upon a reasonable belief that such foreign shipowners are required to file regular corporate income tax returns for the freight payments received by them and to compute their Philippine income tax liability on the basis of the formula prescribed in Section 163 of the Income Tax Regulations, petitioner can hardly be said to have filed a false return, much more a fraudulent return with intent to evade tax. While it is true that it was on the basis of a confidential information that respondent caused the examination of petitioner's books of accounts and respondent issued the assessment in question based on the report of such examination, the records of the freight payments were at all times available for examination by agents of the Bureau of Internal Revenue. There was, therefore, no attempt on

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the part of petitioner to prevent the Government agents from making proper assessment of its tax liability arising from such freight payments remitted abroad.

It follows that, just like the Barcelona case, supra, this is plainly a case arising under "normal circumstances" referred to in the Aznar decision to which the five-year period provided in Section 331 of the Revenue Code is properly applicable. This is entirely different from the Aznar case where the assessment was the result of the application of the net worth expenditures method of determining unreported income. This method of assessment is resorted to only in cases where the sources of the unreported income of a taxpayer are not definitely ascertainable. (See Barcelona vs. Commissioner of Internal Revenue, supra.) Since petitioner filed its 1965 annual return of income tax at source on April 13, 1966 covering income payments to non-resident aliens or corporations during the year 1965, and the demand letter dated October 15, 1971, together with the corresponding assessment notice which was issued only on October

22, 1971 and was received by petitioner on October 26, 1971, it is obvious that the right of respondent to assess the withholding tax on freight payments made in 1965 has already prescribed under Section 331 of the Revenue Code.

From the evidence on record, it appears that the total amount of freight payments remitted to non-resident foreign shipping corporations which respondent considers as subject to withholding tax for 1965 is ₱1,066,075.37 while the total amount of freight payments for 1966 is ₱3,647,202.63. (See Exh. "2", p. 36, BIR rec.) Therefore, only the assessment of the deficiency withholding tax with respect to the amount of ₱3,647,202.63 has been made by respondent within the statutory period of limitation prescribed in Section 331 of the National Internal Revenue Code.

Anent the third issue, the basis of respondent in imposing the 25% surcharge authorized under Section 72 of the Tax Code is the failure or omission of petitioner to file the withholding tax returns at source of the freight payments in question, although respondent also argues, additionally, that the mere fact that petitioner filed withholding income tax returns at source for payments other than those involved in this case will not relieve petitioner of the 25% surcharge. The 25% surcharge may be imposed only, as may be gleaned from a reading of Section 72, in case of failure to make and file a return or list within the time prescribed by law, not due to willful neglect. Since, as shown above, petitioner made and filed the withholding tax returns for 1965 and 1966, it follows that there is no factual and legal basis for the imposition of the 25% surcharge. And the fact that petitioner did not include the freight payments in question in such returns will not in anyway change the situation because its failure to do so is due to an honest belief that the said payments to the foreign shipowners were not subject to withholding of tax at source.

In resume, we are of the opinion that (1) petitioner is under legal obligation to deduct and withhold from the freight payments remitted by it to non-resident foreign shipping corporations the income tax due thereon, file the requisite withholding returns and pay the tax withheld to the Bureau of Internal Revenue; (2) the right of respondent to assess the withholding tax on freight payments made in 1965 has already prescribed under Section 331 of the Revenue Code; and (3) petitioner is not liable for the 25% surcharge under Section 72 of the National Internal Revenue Code.

In line with the foregoing, the decision appealed from is modified and petitioner is liable to pay to respondent the amount of ₱1,810,617.27, computed as follows:

Total amount remitted - 1966 . . .	₱3,647,202.63
30% withholding tax due thereon	1,094,160.79
Add: 1/2% mo. int. from 10/16/66 to 10/16/69	196,948.94
Deficiency withholding income tax due	₱ 1,291,109.73
Add: 5% surcharge on ₱1,094,160.79	54,708.04
1% mo. int. from 10/15/71 to 10/14/74	464,799.50
TOTAL AMOUNT DUE AND COLLECTIBLE	₱ 1,810,617.77

WHEREFORE, petitioner Procter & Gamble Philippine Manufacturing Corporation is hereby ordered to pay to respondent Commissioner of Internal Revenue the amount of ₱1,810,617.27 as deficiency withholding income tax for the fiscal year ended June 30, 1966.

With costs against petitioner.

SO ORDERED.

Quezon City, January 4, 1977.

Amante Filler

AMANTE FILLER
Associate Judge

I CONCUR:

CONSTANTE C. ROAQUIN
Associate Judge