REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

SECOND DIVISION

CE PHILIPPINES LTD.,
Petitioner,

-versus-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA CASE NO. **7688**

Members:

CASTAÑEDA, JR., *Chairperson*
CASANOVA, and
MINDARO-GRULLA, J.J.

Promulgated:

DEC 23 2010 1:20 p.m.

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DECISION

MINDARO-GRULLA, J.:

This is a Petition for Review filed on October 17, 2007 by CE PHILIPPINES LTD., as petitioner, against the Commissioner of Internal Revenue (CIR) as respondent, for the Court in Division, pursuant to Rule 4, Section 3 (a) (2), in relation to Rule 8, Section 4(a), of the Revised Rules of the Court of Tax Appeals (RRCTA).

The said Petition is an appeal from respondent CIR's inaction over petitioner's administrative claim for a tax refund or tax credit[1] in the aggregate amount of P29,700,584.82, representing alleged excess capital gains tax (CGT) paid on the gains realized from the redemption by CE Philippines II, Inc. (CEP II) of its Series A preferred shares owned by petitioner on September 15, 2005 and October 17, 2005.

Petitioner CE Philippines Ltd. is a non-resident foreign corporation duly organized and existing under and by virtue of the laws of Bermuda with principal place of business at Clarendon House, Church St., Hamilton, Bermuda.[2]

Respondent is the duly appointed Commissioner of the Bureau of Internal Revenue (BIR), empowered to perform the duties of said office including, among others, the duty to act upon and approve claims for refunds or tax credits as provided by law. Respondent holds office at the 5th Floor, BIR National Office Building, Agham Road, Diliman, Quezon City.

On October 22, 1999, CEP II was incorporated and registered with the Securities and Exchange Commission (SEC) primarily to acquire, hold, own and use for investment or otherwise, and to sell or dispose of, any and all properties of every kind and description and

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[1] Exhibits "F" and "I", Docket, pp. 326-333 and 338-345
[2] Exhibits "A", "A-1" and "B", Docket, pp. 298-311

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wherever situated, to the extent permitted by law.[3] CEP II had an authorized capital stock of P80,000.00, divided into 40,000 common shares and 40,000 Series A preferred shares, both with a par value of P1.00 each. CEP II had an issued outstanding capital stock of P20,000.00, divided into 20,000 common shares, 100% of which were legally and beneficially owned by petitioner.[4]

On April 23, 2001, the SEC approved the increase of CEP II's capital stock from P80,000.00 to P11,647,948.00, divided into 2,840,000 common shares and 8,807,948 Series A preferred shares, both with a par value of P1.00 per share.[5]

The entire amount of increase in the capital stock of CEP II (P1,567,948.00, divided into 2,800,000 common shares and 8,767,948 Series A preferred shares, both with a par value of P1.00 per share) was subscribed by petitioner and paid for by way of assignment of 100,000 common shares and 313,141 Series A preferred shares of CE Cebu Geothermal Power Company, Inc. (CE Cebu), which were valued at allegedly US$65,210,000.00, in favor of CEP II. In view of petitioner's subscription to 2,800,000 common shares and 8,767,948 Series A preferred shares of CEP II on April 23, 2001, and its ownership of 20,000

[3] Exhibits "M" and "M-1", Docket, pp. 380-393; Par. II(3), Joint Stipulation of Facts and Issues (JSFI), Docket, p. 94
[4] Exhibits "M" and "M-1", Docket, pp. 380-393; Exhibit "N-1", Docket, pp. 396-402; Exhibits "W" and "W-1", Docket, pp. 455-456
[5] Exhibit "N", Docket, p. 394

common shares prior to the increase in CEP II's capital stock, petitioner became the beneficial and absolute owner of 100% of CEP II's capital stock (*i.e.*, P11,587,948.00, divided into 2,820,000 common shares and 8,767,948 Series A preferred shares).[6]

On March 25, 2004, CEP II obtained approval from the SEC to use the US dollar as its functional currency in presenting its financial statements pursuant to SEC Memorandum Circular No. 14, Series of 2003.[7] Consequently, the financial statements of CEP II were presented in US dollars beginning the taxable year 2003.[8]

On September 15, 2005, CEP II's management, with the approval of the Board of Directors, effected the redemption of 1,113,260 Series A preferred shares at a redemption price of US$8.59, or a total redemption amount of US$9,562,903.40.[9]

The cost per share of the Series A preferred shares is US$5.63.[10] Thus, computing the capital gains based on the functional currency

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[6] Exhibit "N-1, Docket, pp. 396-402; Exhibits "W" and "W-1", Docket, pp. 455-456; and Exhibit "DD", Sworn Statement of Ms. Trinity Gatuz dated June 25, 2008, pp. 4-5

[7] Guidelines on Preparation of Functional Currency Financial Statement; Exhibits "C", "C-1", and "C-2", Docket, pp. 312-315; Exhibit "DD", Sworn Statement of Ms. Trinity Gatuz dated June 25, 2008, pp. 3-4

[8] Exhibits "U", "U-1", "U-2", Docket, pp. 426-441; Exhibit "DD", Sworn Statement of Ms. Trinity Gatuz dated June 25, 2008

[9] Exhibit "D", Docket, pp. 322-323; Exhibit "L", Sworn Statement of Ms. Trinity Gatuz dated May 23, 2008, pp. 4-5

[10] The cost per share is computed by dividing CEP II's paid- up capital as of December 31, 2004 in the amount of US$65,210,000 with the issued and outstanding shares as of redemption date of 11,587,948 shares; Exhibit "L", Sworn Statement of Ms. Trinity Gatuz dated May 23, 2008, pp. 3-4

(by deducting the U.S. dollar cost from the U.S. dollar redemption price of the Series A preferred shares), petitioner realized a capital gain upon redemption of US$2.96 per share, or a total of US$3,295,249.60, computed as follows:

Capital Gain on the Redemption – in U.S. dollars

Redemption value per share	US$ 8.59
Cost per share	5.63
Capital gain per share – in U.S. dollars	US$ 2.96
No. of shares redeemed	1,113,260.00
Capital gain – in U.S. dollars	US$ 3,295,249.60

However, for purposes of computing the capital gain and paying the CGT due, petitioner used the peso equivalent of the redemption price (based on the Philippine Dealing System' closing rate on the redemption date) and the peso equivalent of the cost per share (which was translated based on historical rate), resulting in a capital gain of P370,729,950.66, computed as follows:

Redemption Value per share in Philippine Pesos:

Redemption price per share in US $	US$ 8.59	
x PDS closing rate – Sept. 15, 2005	P 55.925	P 480.39
Less: Cost per share in Philippine Pesos		
Paid-up Capital per Phil. Peso Books	P 1,707,864,702.00	
÷ No. of shares outstanding	11,587,948	147.38
Capital Gain per share		P 333.01
No. of shares redeemed		1,113,260
Capital Gain		**P370,729,950.66**

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Based on the above computation, petitioner filed its Capital Gains Tax Return (BIR Form No. 1707)[11] on October 17, 2005, and paid CGT in the amount of P37,067,995.07, computed as follows:

Peso Equivalent of US Dollar Capital Gain	Rate	Capital Gains Tax
P 100,000.00	at 5%	P 5,000.00
370,629,950.66	at 10%	37,062,992.07
P 370,729,950.66		P 37,067,995.07

On October 17, 2005, CEP II's management, with the approval of its Board of Directors, effected the redemption of 662,290 Series A preferred shares at a redemption price of US$8.59, or a total redemption amount of US$5,689,071.10.[12]

The cost per share of the Series A preferred shares is US$5.63.[13] Thus, computing the capital gains by deducting from the redemption price in US dollars the original cost which is also in US dollars, petitioner realized a capital gain upon redemption of $2.96 per share or a total of $1,960,378.40, computed as follows:

Capital Gain on the Redemption – in US dollars:

[11] Exhibit "E", Docket, pp. 324-325; Par. II(6), JSFI, Docket, p. 95

[12] Exhibit "G", Docket, pp. 334-335; Par. II(9), JSFI, Docket, p. 95; Exhibit "L", Sworn Statement of Ms. Trinity Gatuz dated May 23, 2008, p. 5

[13] The cost per share is computed by dividing the paid-up capital as of December 31, 2004 in the amount of $65,210,000.00 with the issued and outstanding shares as of said date of 11,587,948 shares; Exhibit "L", Sworn Statement of Ms. Trinity Gatuz dated May 23, 2008, pp. 3-4

Redemption value per share	US$	8.59
Cost per share		5.63
Capital gain per share – in US dollars	US$	2.96
No. of shares redeemed		662,290
Capital gain – in US dollars	US$	1,960,378.40

However, for purposes of computing the capital gain and paying the CGT due, petitioner again used the peso equivalent of the redemption price (based on the Philippine Dealing System' closing rate on the redemption date) and the peso equivalent of the cost per share (which was translated based on historical rate), resulting in a capital gain of P220,010,657.50, computed as follows:

Redemption Value per share in Philippine Pesos:

Redemption price per share in US $	US$ 8.59	
x PDS closing rate – Oct. 17, 2005	P 55.83	P 479.58
Less: Cost per share in Philippine Pesos		
Paid-up Capital per Phil. Peso Books	P 1,707,864,702.00	
÷ No. of shares outstanding	11,587,948	147.38
Capital Gain per share		P 332.20
No. of shares redeemed		662,290
Capital Gain		**P 220,010,657.50**

Based on the above computation, petitioner filed its Capital Gains Tax Return (BIR Form No. 1707)[14] on November 16, 2005, and paid the CGT in the amount of P21,996,065.75, computed as follows:

Peso Equivalent of US Dollar Capital Gain	Rate	Capital Gains Tax
P 100,000.00	at 5%	P 5,000.00
219,910,657.50	at 10%	21,991,065.75
P 220,010,657.50		P 21,996,065.75

[14] Exhibit "H", Docket, pp. 336-337; Par. II(10), JSFI, Docket, p. 95

On October 5, 2007, petitioner filed an administrative claim for refund with the BIR Large Taxpayers District Office No. 122, requesting for a refund of the amount of P18,644,311.68 and P11,056,273.14, representing the alleged excess CGT paid on the gain realized from the redemption by CEP II of its Series A preferred shares owned by petitioner on September 15, 2005 and October 17, 2005, respectively.[15]

The above administrative claim for refund by petitioner was computed based on the following:

A. September 15, 2005 capital gain on redemption:

Redemption value per share – in US dollars	8.59
Cost per share – in US dollars	5.63
Capital gain per share	2.96
No. of shares redeemed	1,113,260
Capital gain – in US dollars	$ 3,295,249.60
PDS closing rate September 15, 2005	55.925
Capital gain – in Philippine peso	P 184,286,833.88

CGT due

Capital gain	Rate	CGT
P 100,000.00	at 5%	P 5,000.00
184,186,833.88	at 10%	184,286,833.88
18,418,683.39		P 18,423,683.39

Excess CGT paid

Capital Gains Tax paid	P 37,067,995.07
Capital Gains Tax due	18,423,683.39
Excess Capital Gains Tax Paid	P18,644,311.68

[15] Exhibits "F", Docket, pp. 326-333 and Exhibit "I", Docket, pp. 338-345; Pars. II(7) and II(11), JSFI, Docket, p. 95

B. October 17, 2005 capital gain on redemption:

Redemption value per share – in US dollars	8.59
Cost per share – in US dollars	5.63
Capital gain per share	2.96
No. of shares redeemed	662,290
Capital gain – in US dollars	$ 1,960,378.40
PDS closing rate September 15, 2005	55.83
Capital gain – in Philippine peso	P 109,447,926.07

CGT due

Capital gain	Rate	CGT
P 100,000.00	at 5%	P 5,000.00
109,347,926.07	at 10%	10,934,792.61
109,447,926.07		P 10,939,792.61

Excess CGT paid

Capital Gains Tax paid	P 21,996,065.75
Capital Gains Tax due	10,939,792.61
Excess Capital Gains Tax Paid	₱ 11,056,273.14

Respondent interposed the following Special and Affirmative Defenses in the Answer[16] to the Petition for Review:

"6. Assuming but without admitting that Petitioner filed a claim for refund, the same is still subject to investigation by the Bureau of Internal Revenue;

7. Petitioner failed to demonstrate that the tax, which is the subject of this case, was erroneously or illegally collected;

8. Petitioner has no legal capacity to sue;

9. Taxes paid and collected are presumed to be made in accordance with the laws and regulations, hence, not creditable or refundable;

[16] Docket, pp. 65-66

10. It is incumbent upon the Petitioner to show that it has complied with the provision of Section(s) 204(C) in relation to Section 229 of the 1997 Tax Code, as amended;

11. In an action for tax credit or refund, the burden is upon the taxpayer to prove that it is entitled thereto, and failure to discharge the said burden is fatal to the claim (*Emmanuel & Zenaida Aguilar v. Commissioner, CA-GR No. Sp. 16432, March 30, 1990 cited in Aban, Law of Basic Taxation in the Phippines, 1st Edition, p. 206*);

12. Claims for refund are construed strictly against the claimant, the same partake the nature of exemption from taxation (*Commissioner of Internal Revenue vs. Ledesma, 31 SCRA 95*) and as such, they are looked upon with disfavor. (*Western Minolco Corp. vs. Commissioner of Internal Revenue, 124 SCRA 121*)."

On March 17, 2008, respondent filed a Motion to Dismiss[17] on the ground that petitioner lacks the legal capacity to sue, which this Court denied in its Resolution[18] dated May 14, 2008.

During trial, petitioner presented its sole witness, Ms. Trinity Gatuz, CEP II's Vice President, who executed and identified her Judicial Affidavits dated May 23, 2008,[19] June 25, 2008,[20] August 1, 2008,[21] November 19, 2008[22] and February 18, 2009[23].

Thereafter, petitioner formally offered on April 30, 2009 Exhibits "A" to "QQ", inclusive of sub-markings, to support its claims. This Court

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[17] Docket, pp. 100-106
[18] Docket, pp. 131-135
[19] Exhibits "L" and "L-1" , Docket, pp. 370-379
[20] Exhibits "DD" and "DD-1", Docket, pp. 498-505
[21] Exhibits "EE" and "EE-1", Docket, pp. 508-520
[22] Exhibits "MM", and "MM-1", Docket, pp. 569-579
[23] Exhibits "QQ" and "QQ-1", Docket, pp. 592-595

resolved to admit all of said exhibits in its Resolution dated June 22, 2009.

On September 11, 2009, respondent filed a Manifestation[24] stating that there is no report of investigation on petitioner's claim for refund and respondent is submitting this case for resolution based on available records.

On January 13, 2010[25], the case was submitted for decision taking into consideration petitioner's Memorandum[26] filed on December 16, 2009, sans respondent's Memorandum.

As agreed upon by the parties, the main issue is whether petitioner is entitled to the refund or issuance of a tax credit certificate amounting to P29,700,584.82, representing the excess CGT paid on the gains realized from the redemption by CEP II of its Series A preferred shares owned by petitioner on September 15, 2005 and October 17, 2005.

The sub - issues, are as follows:

> "1. Whether or not petitioner has legal capacity to sue in the Philippines;
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> 2. Whether or not petitioner has erroneously over-remitted CGT in the amounts of P18,644,311.68 and P11,056,273.14 in relation to the gains realized from the redemption on September 15, 2005 and October 17, 2005, respectively, by CEP II of its Series A preferred shares owned by petitioner;

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[24] Docket, pp. 604-605
[25] Docket, p. 643
[26] Docket, pp. 617-642

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3. Whether or not petitioner remitted and paid to the BIR capital gains tax in the amount of P37,067,995.07 and P21,996,065.75 in relation to the gains realized from the redemption on September 15, 2005 and October 17, 2005, respectively, by CEP II of its Series A preferred shares owned by petitioner; and

4. Whether or not petitioner filed its administrative and judicial claims for refund or issuance of TCC for the amounts of P18,644,311.68 and P11,056,273.14, representing the excess CGT paid on the gains realized from the redemption by CEP II of its Series A preferred shares owned by petitioner on September 15, 2005 and October 17, 2005, respectively, within the two-year prescriptive period provided under Sections 204(C) and 229, Tax Code."[27]

Suffice it to say that anent the timeliness of petitioner's administrative and judicial claims for refund, records reveal that petitioner filed its Capital Gains Tax Return (BIR Form 1707)[28] and paid the capital gains tax in the amount of P37,067,995.07 on October 17, 2005, representing gains realized from the redemption on September 15, 2005 by CEP II of its Series A preferred shares owned by petitioner. Petitioner also filed its Capital Gains Tax Return (BIR Form No. 1707)[29] on November 16, 2005 and paid the CGT in the amount of P21,996,065.75, representing gains realized from the redemption on October 17, 2005 by CEP II of its Series A preferred shares owned by petitioner.

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[27] Docket, pp. 96-97.
[28] Exhibit "E", Docket, pp. 324-325
[29] Exhibit "H", Docket, pp. 336-337

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On October 5, 2007, petitioner filed an administrative claim for refund in the amount of P18,644,311.68 and P11,056,273.14 with the BIR Large Taxpayers District Office No. 122.

On October 17, 2007, petitioner filed with this Court the instant Petition for Review, due to respondent's inaction on petitioner's administrative claims for refund, praying for a refund or issuance of a tax credit certificate for its alleged excess capital gains tax paid on the gain realized from the redemption by CEP II of its Series A preferred shares on September 15, 2005 and October 17, 2005 in the amount of P29,700,584.82. Petitioner filed the instant Petition for Review within the two-year prescriptive period to file claim for a refund/issuance of tax credit under Section 229 of National Internal Revenue Code (NIRC) of 1997.

As to the main issue, Sections 24(C) and 25(B) of the NIRC of 1997, provide as follows:

"SEC. 24. *Income Tax Rates.*

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(C) *Capital Gains from Sale of Shares of Stock not Traded in the Stock Exchange.* - The provisions of Section 39(B) notwithstanding, **a final tax at the rates prescribed below is hereby imposed upon the net capital gains realized during the taxable year from the sale, barter, exchange or other disposition of shares of stock in a domestic corporation**, except shares sold, or disposed of through the stock exchange.

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Not over P100,000...............	5%
On any amount in excess of P100,000......	10%

SEC. 25. *Tax on Nonresident Alien Individual.*

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(B) *Nonresident Alien Individual Not Engaged in Trade or Business Within the Philippines.* - There shall be levied, collected and paid for each taxable year upon the entire income received from all sources within the Philippines by every nonresident alien individual not engaged in trade or business within the Philippines as interest, cash and/or property dividends, rents, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable annual or periodic or casual gains, profits, and income, and capital gains, a tax equal to twenty-five percent (25%) of such income. **Capital gains realized by a nonresident alien individual not engaged in trade or business in the Philippines from the sale of shares of stock in any domestic corporation and real property shall be subject to the income tax prescribed under Subsections (C) and (D) of Section 24.**"*(Emphasis supplied)*

Likewise, Section 42(E) of the NIRC of 1997 reads:

"*SEC. 42. Income from Sources Within the Philippines.-*

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(E) Income From Sources Partly Within and Partly Without the Philippines. -

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Gains, profits and income derived from the purchase of personal property within and its sale without the Philippines, or from the purchase of personal property without and its sale within the Philippines shall be treated as derived entirely from sources within the country in which sold: *Provided, however,* **That gain from the sale of shares of stock in a domestic corporation shall be treated as derived entirely from sources within the Philippines regardless of where the said shares are sold**. The transfer by a nonresident alien or a foreign corporation to anyone of any share of stock issued by a domestic corporation shall not be effected or made in its book

> unless: (1) the transferor has filed with the Commissioner a bond conditioned upon the future payment by him of any income tax that may be due on the gains derived from such transfer, or (2) the Commissioner has certified that the taxes, if any, imposed in this Title and due on the gain realized from such sale or transfer have been paid. It shall be the duty of the transferor and the corporation the shares, of which are sold or transferred, to advise the transferee of this requirement." (*Emphasis supplied*)

Based on the foregoing, capital gains realized by a non-resident alien individual not engaged in trade or business in the Philippines from the sale of shares of stock in any domestic corporation shall be subject to the income tax prescribed under Section 24(C), with tax rates of five percent (5%), for the amount not over P100,000.00, and ten percent (10%), in excess thereof.

The gain from the sale of shares of stock in a **domestic corporation** shall be treated as derived entirely from **sources within the Philippines** regardless of where the said shares are sold.

In the instant case, it is undisputed that CEP II is a domestic corporation, while petitioner is a *non-resident alien individual not engaged in trade or business within the Philippines*; which is made liable by the foregoing provisions for **net capital gains tax**, representing the gains realized from the redemption by CEP II of its Series A preferred shares owned by petitioner on September 15, 2005 and October 17, 2005.

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Records show that petitioner filed the Capital Gains Tax Return (BIR Form No. 1707)[30] and paid the capital gains tax in the amount of P37,067,995.07 on **October 17, 2005** representing gains realized from the redemption on September 15, 2005 by CEP II of its Series A preferred shares owned by petitioner. Petitioner also filed its Capital Gains Tax Return (BIR Form 1707)[31] **on November 16, 2005** and paid the CGT in the amount of P21,996,065.75 representing gains realized from the redemption on October 17, 2005 by CEP II of its Series A preferred shares owned by petitioner.

On March 16, 2006, the Bureau of Internal Revenue issued Revenue Regulations No. 06-06, regulating the use of functional currency other than the Philippine Peso in Financial Statements that will be submitted and in the Books of Accounts that will be maintained for Internal Revenue Tax purposes.

Revenue Regulations No. 06-06 defines "Functional Currency" as the currency of the primary economic environment in which the reporting entity operates; that is the currency of the environment in which an entity primarily generates and expends cash. The foregoing regulation likewise provides that:

> "SECTION 8. *Currency to be Used in the Filing of Tax Returns Other than Income Tax.* — **All tax returns other than the ITR shall**

[30] Exhibit "E", Docket, p. 324-325; Par. II(6), JSFI, Docket p. 95
[31] Exhibits "H" and "H-I", Docket, p. 336-337; Par. II(10), JSFI, Docket p. 95

likewise be filed in Philippine peso currency using historical peso amount or actual conversion/prevailing PDS rate on transaction day, whichever is applicable.

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SECTION 12. *Treatment of Gain or Loss on Sale of Investment Under Functional Currency.* — An investor which invests in functional currency (other than Philippine peso) securities can compute its gain or loss from the sale of said investment using the functional currency.

For example, if Company A invests in a US dollar bond at US$100,000 when the US$:P rate was US$1:40 and sells the same investment at US$102,000 when the US$:P rate was US$1:50, the computation of the capital gain shall be as follows:

	USD	*Pesos*
Selling price	102,000	5,100,000
Cost	100,000	4,000,000
Taxable Gain	2,000	

In the above illustration, the taxable gain that should be reported is only $2,000. Thus, in reporting for tax purposes of the $2,000 gain in equivalent or converted Philippine peso denomination, the equivalent peso denomination is the peso equivalent of 2,000 U.S. dollars using the conversion rate on the date of the consummation of the transaction.

The above rule shall also apply to non-resident stockholders of an investee company where such investee company in the Philippines uses a functional currency other than the Philippine peso for its financial statements.

However, if an investor makes an investment in Philippine peso, then it shall compute the gain or loss from sale of said investment using the Philippine peso cost and Philippine peso selling price." *(Emphasis supplied)*

On March 25, 2004, CEP II obtained approval from the SEC to use the US dollar as its functional currency in presenting its financial statements pursuant to SEC Memorandum Circular No. 14, Series of

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2003.[32] Consequently, the financial statements of CEP II were presented in U.S. dollars beginning the taxable year 2003.[33] Thus, CEP II effected the redemption of 1,113,260 Series A preferred shares at a redemption price of US$8.59, or a total redemption amount of US$9,562,903.40[34] and the subsequent redemption of 662,290 Series A Preferred Shares at a redemption price of US$8.59, or a total redemption amount of US$5,689,071.10[35] instead of using the Philippine currency.

However, prior to March 25, 2004, when CEP II was incorporated and registered with the Securities and Exchange Commission and when petitioner subscribed and paid its subscription, the par value of CEP II's common and Series A preferred shares were denominated in Philippine currency. The facts clearly indicate that the entire amount of increase in the capital stock of CEP II (*i.e.*, P11,567,948.00, divided into 2,800,000 common shares and 8,767,948 Series A preferred shares, both with a par value of P1.00 per share) had been subscribed by petitioner and paid for by way of assignment of 100,000 common shares and 313,141 Series A preferred shares of CE Cebu Geothermal

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[32] Guidelines on Preparation of Functional Currency Financial Statement; Exhibits "C", "C-1", and "C-2"; Exhibit "DD", Sworn Statement of Ms. Trinity Gatuz dated June 25, 2008, Docket, pp. 498-505

[33] Exhibits "U", "U-1", "U-2"; Exhibit "DD" Sworn Statement of Ms. Trinity Gatuz dated June 25, 2008, Docket, pp. 498-505

[34] Exhibit "D"; Exhibit "L" Sworn Statement of Ms. Trinity Gatuz dated May 23, 2008, Docket, pp. 370-379

[35] Exhibit "G"; Par. II(9), JSFI; Exhibit "L", Sworn Statement of Ms. Trinity Gatuz dated May 23, 2008,Docket, pp. 370-379

Power Company, Inc., which were valued at US$65,210,000.00. In view of petitioner's subscription to 2,800,000 common shares and 8,767,948 Series A preferred shares of CEP II on April 23, 2001, and its ownership of 20,000 common shares prior to the increase in CEP II's capital stock, petitioner became the beneficial and absolute owner of 100% of CEP II's capital stock (*i.e.*, P11,587,948.00, divided into 2,820,000 common shares and 8,767,948 Series A preferred shares).[36]

As the absolute owner of 100% of CEP II, a **domestic corporation** whose capital stock is denominated in **Philippine Peso**, petitioner's investment clearly translates to Philippine Peso, even though the source of such investment may be in other foreign currency denominated unit (FCDU). Petitioner effectively makes an investment in Philippine Peso, and according to Revenue Regulations No. 06-06, **it shall compute the gain or loss from sale of said investment using the Philippine Peso cost and Philippine Peso selling price**.

Petitioner computed its claim for refund by finding the difference of the redemption value per share in **US dollars** against the cost per share, also in **US dollars**, and such difference is multiplied by the number of shares redeemed by CEP II, resulting in its computed capital gains tax due in **US dollars**. Thereafter, the capital gains tax in

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[36] Exhibits "N-1", "W", and "W-1"; Exhibit "DD", Sworn Statement of Ms. Trinity Gatuz dated June 25, 2008, Docket, pp. 498-505

US dollar is then multiplied by the Philippine Dealing System peso equivalent to one US dollar as of closing date of redemption. This computation lacks legal basis.

It is evident from the provision of Section 24(C) of the NIRC that the capital gains considered in the computation thereof should be in **Philippine Peso** considering that the applicable rate of 5% is based on the amount not over P100,000.00, and the rate of 10% is based on the amount in excess of P100,000.00, which is in Philippine Peso. The law, in fact, did not provide for an FCDU or foreign exchange equivalent of the capital gains to be converted to Philippine Peso as of the date of transaction subject to said tax. Thus, it can be safely concluded that in computing the capital gains in this case, the redemption value per share, the cost per share, and the capital gains subject to tax, should all be in Philippine Peso. Revenue Regulations No. 06-06 reinforced such way of computing the capital gains by providing that "it shall compute the gain or loss from sale of said investment using the Philippine Peso cost and Philippine Peso selling". Here, petitioner computed its capital gains and CGT in the following manner:

September 15, 2005 redemption:

Redemption price per share in US $	US$ 8.59	
x PDS closing rate – Sept. 15, 2005	P 55.925	P 480.39
Less: Cost per share in the Philippine Pesos		
Paid-up Capital per Phil. Peso Books	P 1,707,864,702.00	
÷ No. of shares outstanding	11,587,948	147.38
Capital Gain per share		P 333.01
No. of shares redeemed		1,113,260
Capital Gain		**P 370,729,950.66**

Peso Equivalent of US Dollar Capital Gain	Rate	Capital Gains Tax
P 100,000.00	at 5%	P 5,000.00
370,629,950.66	at 10%	37,062,992.07
P 370,729,950.66		P 37,067,995.07

October 15, 2005 redemption:

Redemption price per share in US $	US$ 8.59	
x PDS closing rate – Oct. 17, 2005	P 55.83	P 479.58
Less: Cost per share in the Philippine Pesos		
Paid-up Capital per Phil. Peso Books	P1,707,864,702.00	
÷ No. of shares outstanding	11,587,948	147.38
Capital Gain per share		P 332.20
No. of shares redeemed		662,290
Capital Gain		**P 220,010,657.50**

Peso Equivalent of US Dollar Capital Gain	Rate	Capital Gains Tax
P 100,000.00	at 5%	P 5,000.00
219,910,657.50	at 10%	21,991,065.75
P 220,010,657.50		P 21,996,065.75

As discussed, CEP II is a domestic corporation with an authorized capital stock denominated in Philippine Peso. The basis of purchasing

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such shares of stock is necessarily in Philippine Peso, the same having been necessarily reflected in the books/records of CEP II.[37]

Moreover, this Court had ruled in a similar case entitled *CE Philippines Ltd. vs. Commissioner of Internal Revenue*[38], which involved the same parties and similar claim for refund of excess capital gains tax paid on the gain realized from redemption made by CEP II of its preferred shares owned by CE Philippines, Ltd. In the said case, this Court denied petitioner's claim for a refund or issuance of a tax credit certificate by ruling that despite the fact that at the time CEP II redeemed its shares from petitioner it was already using the US dollar as its functional currency, it remains undisputed that when petitioner made its investment in CEP II, it did so by using the Philippine Peso. This Court held in this wise:

> "Based on the above discussion, therefore, it is evident that the investment of petitioner to CEP II was made in Philippine peso, since as indicated in the Deed of Assignment as well as in the Treasurer's Affidavit, petitioner has made its investment to CEP II, in Philippine peso, by assigning to CEP II, petitioner's shares in CE Cebu Geothermal Power Company, Inc., consisting of 100,000 common shares of stock with par value of P28.00 and 313,141 Series A preferred shares of stock with par value of P28.00, and amounting to P11,567,948.00 worth of shares. Even assuming that CEP II obtained approval from the Securities and Exchange Commission to use the U.S. Dollar as its functional currency, such approval was only obtained on March 24, 2005. Hence, when the Board of Directors of CEP II issued a resolution authorizing the redemption of its shares from petitioner, consisting of 187,348 Series A Preferred Shares, it computed the redemption price

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[37] Exhibits "M", "M-1", "N-1", and "N-2", Docket, pp. 380-403
[38] CTA Case No. 7641, September 23, 2010

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> using its U.S. Dollar functional currency. However, despite of the fact that at the time CEP II redeemed its shares from petitioner, it was already using the U. S. Dollar as its functional currency, it remains undisputed that when petitioner made its investment to CEP II, it did so by using the Philippine Peso."

It is well settled that petitioner, as taxpayer claimant, has the burden of proof that it is entitled to a refund of the amount claimed as refundable because taxes are presumed to have been collected in accordance with laws and regulations. The burden of proof rests upon the taxpayer to establish by sufficient and competent evidence its entitlement to a refund.[39]

Basic is the rule that tax refunds are in the nature of tax exemptions and are to be construed *strictissimi juris* against the entity claiming the same.[40] Moreover, statutes in derogation of sovereignty, such as those containing exemption from taxation, should be strictly construed in favor of the state.[41]

In fine, for failure of petitioner to establish the factual basis of its claim for refund, this Court is constrained to deny its claim.

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[39] Commissioner of Internal Revenue vs. Tokyo Shipping Co., Ltd., 244 SCRA 336
[40] Philippine Geothermal, Inc. vs. Commissioner of Internal Revenue, G.R. No. 154028, July 29, 2005
[41] PLDT vs. City of Davao, G.R. No. 143867, March 25, 2003

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WHEREFORE, the instant Petition for Review is hereby **DENIED**.

SO ORDERED.

Cielito N. Mindaro-Grulla
CIELITO N. MINDARO-GRULLA
Associate Justice

WE CONCUR:

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

CAESAR A. CASANOVA
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, and the Division Chairperson's Attestation, 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's Division.

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Acting Presiding Justice