REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

THE PHILIPPINE BANKING CORPORATION
(now Global Business Bank, Inc.),
Petitioner,

- versus -

C.T.A. CASE NO. 6057

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
APR 04 2002

x - x

DECISION

This case involves a claim for refund in the amount of P517,836.38 representing tax on interest income from bonds/debt securities which petitioner alleged to be erroneously withheld and remitted to the Respondent pertaining to the month of March 1998 (see Amended Petition for Review, pp. 33-42, CTA records).

Petitioner is a banking corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines.

On various dates starting 1996, petitioner purchased interest-earning bonds and debt securities issued by the Republic of the Philippines, the Bangko Sentral ng Pilipinas, the National Power Corporation and the Philippine Long Distance Telephone Company, to wit:

Type of Bonds/Notes Debt Securities/Issuer	Amount
Notes (PLDT)	US$ 1,000,000.00
NPC 02	1,000,000.00
Debt Conversion Bonds (BSP)	1,000,000.00
New Bonds (ROP)	16,000,000.00
	US$19,000,000.00

Petitioner accrues interest on the aforementioned bonds/debt securities on a monthly basis and during the month in which interest is accrued, it allegedly pays the tax on the interest and remits the amount together with their income taxes withheld on its Foreign Currency Deposit Unit (FCDU) income.

For the month of March 1998, the total net accrued interest earnings on these bonds/debt securities was US$137,196.64. The Bank paid the tax on the net accrued interest in the amount of US$13,719.66, and remitted the same together with other income taxes withheld for the month of March 1998 on its FCDU income. The exchange rate utilized by the Bank at that time was P37.817 to US$1.00. So the Philippine currency equivalent of the tax on the net accrued interest for the month of March was P517,836.38.

Petitioner avers that during the latter part of 1999, it discovered that the bonds/debt securities it purchased were actually "tax free covenant bonds". And under the terms and conditions of the issue, the issuer obligated itself to pay the taxes with respect to the interest, without deduction of any amounts from the interest to be remitted to the owners of the bonds/debt securities. Hence, petitioner is no longer under any obligation to withhold and remit the tax on said interest income.

Consequently, petitioner filed a written claim for refund with the Commissioner of Internal Revenue on April 10, 2000 (Exhibit D). On that very same day, which was the last day of the two-year prescriptive period within which to file a claim for refund, the instant petition was filed. Thus, it is worth noting that it is not proper for the petitioner to assert inaction or non-resolution on the part of the Respondent.

Respondent, by way of Special and Affirmative Defenses, states that:

> 1. The petition states no cause of action as it does not allege the dates when the taxes sought to be refunded were actually paid;
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> 2. Claims for refund are construed strictly against the claimant, the same being in the nature of exemption from taxes;
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> 3. One who claims to be exempt from payment of a particular tax must do so under clear and unmistakable terms found in the statute;
>
> 4. In action for refund, the burden is upon the taxpayer to prove that he is entitled thereto, and failure to sustain the same is fatal to the action for tax refund;
>
> 5. It is incumbent upon Petitioner to show compliance with the provisions of Section 229 of the National Internal Revenue Code;
>
> 6. Taxes paid and collected are presumed to have been made in accordance with the law and regulations, hence not refundable.

To support its case, petitioner submitted several documents which were identified by its lone witness.

Respondent, upon the other hand, was considered to have waived his right to present evidence due to counsel's continuous absence in court (p. 172, CTA records).

The parties jointly stipulated that the issues to be resolved by this Court are:

1. Whether or not the petitioner erroneously withheld and remitted income tax on "tax-free covenant bonds" when it should not have withheld any tax.

2. Whether or not the petitioner is entitled to a tax refund in the amount of P517,836.38.

Petitioner claims that it erroneously withheld and remitted tax on interest income from "tax free covenant bonds".

Section 57 of the Tax Code, as amended, prescribes the proper withholding of taxes on tax free covenant bonds, to wit:

> **Section 57.** ***Withholding tax at source.*** –
>
> x x x x x x x x x
>
> (c) Tax-free covenant bonds. - In any case where bonds, mortgages, deeds of trust or other similar obligations of domestic or resident foreign corporations, contain a contract or provision by which the obligor agrees to pay any portion of the tax imposed in this Title upon the obligee or to reimburse the obligee for any portion of the tax or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon or to retain therefrom under any law of the Philippines, or any state or country, <u>the obligor shall deduct and withhold a tax equal to thirty percent (30%) of the interest or other payments upon those bonds, mortgages, deeds of trust or other obligations,</u> whether the interest or other payments are payable annually or at shorter or longer periods, and whether the bonds, securities or obligations had been or will be issued or marketed, and the interest or other payment thereon paid, within or without the Philippines, if the interest or other payment is payable to a non-resident alien or to a citizen or resident of the Philippines. (Underscoring supplied.)

It is clear from the aforequoted law that if the obligor agrees to pay the required tax or a portion thereof or reimburse any portion of tax paid by the obligee or to pay the interest without deduction for any tax which it may be required or permitted to pay or to retain therefrom, it is incumbent upon the obligor to withhold and remit a tax equal to thirty percent (30%) of the interest or other payments upon those bonds to the government.

Corollary thereto, Section 2.58 of Revenue Regulations No. 2-98, as amended, requires that final withholding tax be deducted and withheld on a monthly basis, viz:

> **Section 2.58.** ***Returns and payment of taxes withheld at source.***
>
> (A) Monthly return and payment of taxes withheld at source –
>
> (1) Where to file - Creditable and final withholding taxes deducted and withheld by the withholding agent shall be paid upon filing a return in duplicate with the authorized agent banks located within the Revenue District Office (RDO) having jurisdiction over the residence or principal place of business of the withholding agent. In places where there is no authorized agent banks, the return shall be filed directly with the Revenue District Officer, Collection Officer or the duly authorized Treasurer of the city or municipality where the withholding agent's residence or principal place of business is located, or where the withholding agent is a corporation, where the principal office is located except in cases where the Commissioner otherwise permits.
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> (2) When to file –
>
> (a) The withholding tax return, whether creditable or final, shall be filed and payments should be made within ten (10) days after the end of each month except for the taxes

withheld for December which shall be filed on or before January 25 of the following year.

Applying now the appropriate provisions of law and regulations, We have to determine first whether or not the petitioner purchased interest-earning bonds and debt securities from the Republic of the Philippines (ROP), Bangko Sentral ng Pilipinas (BSP), National Power Corporation (NPC) and the Philippine Long Distance Telephone Company (PLDT).

Petitioner's witness testified that by way of proof that the bank purchased tax-free covenant bonds, they submitted the confirmation of sales received from counter parties or sellers of the bonds (TSN, February 13, 2001, pp. 9-10). Accordingly, petitioner submitted the following fax transmissions sent by the counter parties:

Kinds of Bonds	Counter Party	Amount	Exh.
PNOC Energy Development Bonds	Chemical Bank	US$1,000,000	H
PLDT Eurobonds	ING Bank	1,000,000	H-1
NPC bonds	ING Bank	1,000,000	H-2
ROP bonds	Chase Manhattan International, Ltd.	1,000,000	H-5
ROP bonds	Chase Manhattan International, Ltd.	1,000,000	H-6
ROP bonds	Chase Manhattan International, Ltd.	1,000,000	H-9
ROP bonds	Chase Manhattan International, Ltd.	1,000,000	H-10
ROP bonds	Chase Manhattan International, Ltd.	1,000,000	H-12
ROP bonds	Chase Manhattan International, Ltd.	1,000,000	H-13
ROP bonds	Chase Manhattan International, Ltd.	1,000,000	H-19

Plainly from the documents so presented, petitioner purchased PLDT bonds, PNOC bonds and US$7,000,000.00 of ROP bonds. PNOC bonds however, are no longer part of the claim as per the Amended Petition for Review. Also, it must be noted that part of the claim covers payment on interest of US$16,000,000.00 worth of ROP bonds as well as interest paid on US$1,000,000.00 worth of BSP bonds. However, petitioner did not submit documents to prove that it bought BSP bonds. And petitioner presented only seven confirmation of sales for ROP bonds or only US$7,000,000 worth of ROP bonds are supported by evidence.

Anent thereto, ascertainment of whether or not the purchased bonds are tax-free covenant bonds is proper.

Herein petitioner offered the prospectus of PLDT long-term Euro bond to prove its claim that it bought tax free covenant bonds from PLDT (Exhibit I). We may accept the same as proof but only as regards PLDT bonds. For the rest of the purchased bonds which are the subject matter in this case, petitioner did not show any evidence that it purchased tax free covenant bonds. In short, petitioner failed to substantiate the allegation that it purchased tax free covenant bonds except for the PLDT bonds.

Proceeding now to the focal issue of whether or not petitioner erroneously withheld and remitted income tax on "tax-free covenant bonds", we rule against the petitioner.

At first blush, the term "tax-free covenant bonds" is quite deceiving. In reality, it does not mean that no tax is due and payable thereon. It is "tax-free" only on the part of the buyer because it is not required to pay any tax as the seller of the bonds obligates itself to shoulder whatever tax is imposed by the government.

Under the aforecited Section 57 of the Tax Code, as amended, the obligor in tax-free covenant bonds, is required to deduct and withhold a tax equal to 30% of the interest or other payments upon those bonds. In the case at bar, PLDT undertook to pay the required tax rate of 30% as reflected by its prospectus quoted below:

> *Taxation of Interest*
>
> Under the Philippine National Internal Revenue Code (the "Tax Code"), interest including original issue discount ('OID"), on Debt Securities received by non-resident alien individuals, whether or not engaged in trade or business within the Philippines, is taxed at 30% and that received by non-resident foreign corporations not engaged in trade or business within the Philippines is taxed at 35%. However, interest received by non-resident foreign corporations on "foreign loans" is subject to final withholding tax of 20%. x x x
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> While above, the interest paid on the Debt Securities is generally subject to Philippine withholding taxes as described payment of such taxes with respect to the interest on the Debt Securities will be made by the Company without deduction of any amounts therefor from the interest to be remitted to the owners of the Debt Securities. The owners will generally receive the same amounts they would have received had no such withholding taxes been imposed, as described in "Description of Debt Securities-Additional Amounts." The effect of such contract or provision is to make the Debt Securities "tax-free covenant bonds". With respect to interest on tax free covenant bonds, the Company is required to withhold a tax equal to 30% of the interest if such interest is payable to a non-resident alien or to a citizen or resident of the Philippines or a tax equal to 20% in the case of other registered holders. (Emphasis Ours.)

As provided by Section 57 and the above undertaking it is clear that interest on tax free covenant bonds is subject to 30% tax.

To support its proposition that the tax on interest income had been withheld and remitted to the Bureau of Internal Revenue, petitioner submitted two monthly remittance returns of income taxes withheld for the month of March 1998 (Exhibits A and B). Said documents will undoubtedly disclose that petitioner withheld and remitted 10% tax on its FCDU income. If indeed petitioner erroneously paid the tax on interest income of its purchased tax free covenant bonds, then the tax withheld and remitted should have been 30% of the income on interest as required by the law and provided for in the prospectus and not merely 10%.

Therefore, there can only be one logical reason for the payment of the 10% tax. The 10% tax paid by the petitioner for the month of March 1998 really corresponds to its payment of 10% final income tax on FCDU and not to the payment on interest income on its tax free covenant bonds. Our conclusion finds support in Section 28(A)(7)(b) of the Tax Code, as amended, reproduced below:

> (b) *Income Derived under the Expanded Foreign Currency Deposit System.* - Income derived by a depository bank under the expanded foreign currency deposit system from foreign currency transactions with local commercial banks including branches of foreign banks that may be authorized by the Bangko Sentral ng Pilipinas (BSP) to transact business with foreign currency deposit system units and other depository banks under the expanded foreign currency deposit system, including interest income from foreign currency loans granted by such depository banks under said expanded foreign currency deposit system to residents, shall be subject to a final income tax at the rate of ten percent (10%) of such income.

It must be observed that the amount subject of the claim for refund is alleged to have been paid by the petitioner together with other income taxes withheld for the month of March 1998 on its FCDU income. And under the law, a final tax of 10% should be withheld and remitted to the BIR.

Even granting, for the sake of argument, that petitioner intended to pay the final tax on interest income on its tax free covenant bonds and granting further, that it was not aware that it should not have paid the same, still, the proper tax rate should be 30% and not 10% of the income on interest. So, it would appear that there is a balance or deficiency final tax equivalent to 20%. Inasmuch as there is no proof that PLDT paid the full 30% tax on the interest income on tax free covenant bonds or the 20% tax still due for the subject period if the alleged 10% income tax paid was actually for the interest income on tax free covenant bonds, then there can be no basis for the refund sought. Most importantly, we already resolved that the payment of P526,687.19 for the month of March 1998 pertains to the 10% tax due and payable on FCDU income.

It is decretal that tax refunds are construed in *strictissimi juris* against the taxpayer, failure on the part of the petitioner to sustain its claim is fatal to its case **(Citibank, N.A. vs. Court of Appeals and Commissioner of Internal Revenue, 280 SCRA 459).**

IN VIEW OF ALL THE FOREGOING, the instant Petition for Review is hereby **DENIED** for lack of merit.

SO ORDERED.

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

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

AMANCIO Q. SAGA
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