REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

FORMER SECOND DIVISION

CE PHILIPPINES LTD.,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA CASE NO. 7641

Members:

CASTAÑEDA, JR., *Chairperson*
UY, *and*
PALANCA-ENRIQUEZ, *JJ.*

Promulgated:

SEP 2 3 2010

10:05 a.m.

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DECISION

CASTAÑEDA, JR., *J*.:

Before this Court is a Petition for Review seeking for the refund or issuance of a Tax Credit Certificate (TCC) in the amount of **TWO MILLION NINE HUNDRED SEVENTY TWO THOUSAND FIVE HUNDRED THIRTY SEVEN AND 54/100 PESOS (P2,972,537.54),** representing the excess capital gains tax (CGT) paid on the gain realized from the redemption by CE Philippines II, Inc. (CEP II) of its Series A preferred shares owned by petitioner.

As stipulated by both parties, the following are the facts of the case:[1]

I.

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

2. Section 2 of Revenue Regulations ("R.R.") No. 6-2006[2] defines the term '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."

3. Section 43 of the National Internal Revenue Code (the "Tax Code")[3] provides:

> SEC. 43. *General Rule.* – The taxable income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year), as the case may be, in accordance with the method of accounting regularly employed in keeping with the books of such taxpayer but if no such method of accounting has been employed or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner clearly reflects the income. . .

4. Section 167 of R.R. No. 2-40[4] pertinently states:

> . . . It is recognized that no uniform method of accounting can be prescribed for all taxpayers and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited for his purpose... Any approved standard method of accounting which reflects taxpayer's income may be adopted... gc

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[1] Joint stipulation of Facts and Issues, Docket, pp. 86-92
[2] March 16, 2006
[3] Republic Act No. 8424 (1997), as amended
[4] February 10, 1940

5. In BIR Ruling No. 004-03 dated June 3, 2003, the BIR ruled that:

> In reply, please be informed that this Office has found no statute or regulation that prohibits the use of foreign currency in financial statements of Philippine taxpayers. What the Tax Code requires is that the books be kept in a native language, English or Spanish (Section 234, Tax Code). Besides, the prohibition against the transactions in foreign currency has been lifted with the repeal of R.A. No. 529, the Uniform Currency Act. The Accounting Standards Council in its letter dated July 18, 2001, confirms that Philippine generally accepted accounting principles (GAAP) allows the use of foreign currency in financial statements. Finally, the use of foreign currency for companies whose functional currency is a foreign currency will more clearly reflect income considering that the use of Philippine peso results in artificial foreign exchange losses which distort the real financial condition of those companies. The use of foreign currency is also revenue neutral. (Underscoring supplied)

6. Section 12 of R.R. No. 6-06[5] provides:

> SEC. 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$1:40 and sells the same investment at US$102,000 when the US$:₱ 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

[5] *Supra*

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 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. (Underscoring supplied)

7. Section 17 of R.R. No. 6-06 provides:

SEC. 17. *Transitory Provision* – Taxpayers adopting functional currency financial statements (other than Philippine peso) for the taxable year ending December 31, 2005 shall be covered by these Regulations with respect to their annual income tax return for 2005. said taxpayers shall attach to their tax return a copy of the SEC notification/approval, in the case of corporations, or the notification to BIR under oath, in the case of individuals, of their qualification to use functional currency (other than Philippine peso). The same rules shall apply to taxpayers which were previously qualified to use functional currency financial statements (other than Philippine peso) under the previous SEC rules (SEC Memorandum Circular 14 series of 2003). (Underscoring supplied)

8. Section 229, Tax Code states that:

Section 229. *Recovery of Tax Erroneously or Illegally Collected.* – No suit or proceeding shall be maintained in any court for the recovery of any national internal revenue tax hereafter alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessively or in any manner

> wrongfully collected, until a claim for refund or credit has been duly filed with the Commissioner; but such suit or proceeding may be maintained, whether or not such tax, penalty, or sum has been paid under protest or duress.
>
> In any case, no such suit or proceeding shall be filed after the expiration of two (2) years from the date of payment of the tax or penalty regardless of any supervening cause that may arise after payment: Provided, however, That the Commissioner may, even without a written claim therefore, refund or credit any tax, where on the face of the return upon which payment was made, such payment appears clearly to have been erroneously paid. (Underscoring supplied)

9. In Commissioner of Internal Revenue vs. Victorias Milling, Inc.,[6] the Supreme Court ruled that if the Commissioner of Internal Revenue fails to act on the refund and the two-year period is about to lapse, the taxpayer should institute the appeal to the Court of Tax Appeals without waiting for the decision of the Commissioner.

II

1. Petitioner is not registered as a corporation or partnership with the Philippine Securities and Exchange Commission ("SEC").

xxx xxx xxx

3. CEP II was incorporated with the following primary purpose;

> To acquire by purchase, exchange, assignment, gift or otherwise, and to hold, own and use for investment or otherwise, and to sell, assign, transfer, exchange, lease, let, develop, mortgage, pledge, traffic, deal in, and with, and otherwise operate, manage, enjoy and dispose of, any and all properties of every kind and description and wherever situated, as and to the extent permitted by law, including but not limited to, buildings tenements, warehouses, factories, edifices and structures and other improvements, and bonds, debentures, promissory notes, shares of capital

[6] 22 SCRA 12 (1968)

stock, or other securities or obligations created, negotiated or issued by any corporation, association or other entity, foreign or domestic and while the owner, holder or possessor thereof, to exercise all the rights, powers and privileges of ownership or any other interest therein, including the right to receive, collect and dispose of, any and all rentals, dividends, interests and income, derived therefrom, and the right to vote on any proprietary or other interest, on any shares of the capital stock, and upon any bonds, debentures, or other securities having voting power, so owned or held; and provided that it shall not engage in the business of an open-end or close-end investment company as defined in the Investment Company Act (Republic Act No. 2629).

4. Pursuant to SEC Memorandum Circular 14, Series of 2003,[7] CEP II obtained approval from the SEC on March 25, 2004 to use the U.S. dollar as its functional currency other than the Philippine Peso in presenting its financial statements.

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6. On May 17, 2005, the Board of Directors of CEP II adopted a resolution for the redemption on May 17, 2005 of its 187,348 Series A preferred shares at a redemption price of US$8.59, or a total redemption amount of US$1,609,319.32.

xxx xxx xxx

9. On June 1, 2007, petitioner filed an administrative claim for refund with the BIR Revenue District Office No. 47, requesting the refund of the amount of P2,972,537.54, representing the excess capital gains tax paid on the gain realized from redemption on May 17, 2005 by CEP II of its Series A preferred shares owned by petitioner.

xxx xxx xxx"

Respondent has neither approved nor denied petitioner's administrative claim for refund in the amount of P2,972,537.54, representing

[7] Guidelines on Preparation of Functional Currency Financial Statement

the excess capital gains tax paid on the gain realized from the redemption by CEP II of its Series A preferred shares owned by the petitioner. Hence, petitioner filed before this Court a Petition for Review on June 15, 2007.

In the Answer[8] filed on August 13, 2007, respondent alleged the following Special and Affirmative Defense:

> "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. Taxes paid and collected are presumed to be made in accordance with the laws and regulations, hence, not creditable or refundable;
>
> 9. It is incumbent upon the Petitioner to show that it has complied with the provision of Section 204 (C) in relation to Section 229 of the 1997 Tax Code, as amended;
>
> 10. 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 claim (*Emmanuel & Zenaida Aguilar v. Commissioner, CA-GR No. Sp. 16432, March 30, 1990 cited in Aban; Law of Basic Taxation in the Philippines, 1st Edition, p. 206);*
>
> 11. 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 December 12, 2007, the Court issued a Resolution approving the parties' "Joint Stipulation of Facts and Issues" and terminating the pre-trial.[9] Jc

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[8] Docket, pp. 52-54
[9] Docket, p. 118

During trial, petitioner presented its documentary and testimonial evidence in support of its stand. Respondent, however, manifested in open court on July 15, 2009 that this case has no report of investigation from RDO 47 regarding petitioner's claim for refund and that he is submitting this case for decision based on the pleadings.[10]

The Court ordered both parties to submit their respective Memorandum. After petitioner submitted his memoranda on September 30, 2009, considering that the respondent failed to submit its memoranda, despite notice, the case was submitted for decision on October 9, 2009.

The issues, as jointly stipulated by the parties, are the following:

"1. Whether or not petitioner is entitled to the refund or issuance of a TCC in the amount of P2,972,537.54, representing excess capital gains tax paid on the gain realized from the redemption on May 17, 2005 by CEP II of its Series A preferred shares owned by the petitioner.

2. Whether or not petitioner subscribed to 2,820,000 common shares and 8,767,948 Series A preferred shares of CEP II on April 23, 2001.

3. Whether or not CEP II obtained approval from the SEC to use the U.S. dollar as its functional currency.

4. Whether or not on May 17, 2005, CEP II redeemed from petitioner 187,348 Series A preferred shares at a redemption price of $8.59.

5. Whether or not petitioner has erroneously over-remitted capital gains tax in the amount of P2,972,537.54 in relation to the gain realized from the redemption on May 17, 2005 by CEP II of its Series A preferred shares owned by petitioner.

6. Whether or not petitioner remitted and paid to the BIR capital gains tax in the amount of P5,982,071.77 in relation to the gain realized from the redemption on

[10] Docket, p. 298

May 17, 2005 by CEP II of its Series A preferred shares owned by petitioner.

7. Whether or not petitioner filed its administrative and judicial claims for refund or issuance of TCC in the amount of P2,972,537.54, representing excess capital gains tax paid on the gain realized from the redemption by CEP II of its shares owned by petitioner, within the two-year prescriptive period provided under Section 204 (C) and 229 of the Tax Code.

The foregoing issues raised by both parties boil down to the principal issue of whether or not petitioner is entitled to a refund of or issuance of a tax credit certificate in the amount of P2,972,537.54, representing excess capital gains tax paid on the gain realized from the redemption on May 17, 2005 by CEP II of its Series A preferred shares owned by the petitioner.

The petition is devoid of merit.

In the case at bar, petitioner is liable to pay Capital Gains Tax from the gain it realized from the redemption by CEP II of 187,348 Series A Preferred Shares. Capital Gains Tax is imposed on the gain or profit from the sale of capital assets. *Section 28 (B)(5)(c) of the National Internal Revenue Code (NIRC) of 1997, as amended*, reads:

"**SEC. 28. Rates of Income Tax on Foreign Corporations**. –

xxx xxx xxx

(B) Tax on Certain Incomes Received by a Nonresident Foreign Corporation. –

xxx xxx xxx

(c) Capital Gains from Sale of Shares of Stock Not Traded in the Stock Exchange. – 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.

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

It is admitted that petitioner realized a capital gain upon redemption of its 187,348 Series A preferred shares at a redemption price of $2.96 per share or a total of $554,550.08. CEP II redeemed the said shares at a redemption price of US$8.59 per share or a total redemption amount of US$1,609,319.92 as opposed to its original cost of US$5.63 per share. Consequently, petitioner paid the corresponding Capital Gains Tax in the amount of P5,982,071.77[11] on June 16, 2005, using the peso equivalent of the redemption price and the cost per share. However, petitioner claims that it committed a mistake in the method it used in computing the capital gains tax. Hence, it filed a claim for refund.

Petitioner contends that the gain it realized from the redemption by CEP II of 187,348 Series A Preferred Shares should be determined on the basis of the functional currency (U.S. dollars) adopted by CEP II, which is also the currency of petitioner's original investment. In other words, petitioner's gain should have been computed by deducting the U.S. dollar cost of its original investment from the U.S. dollar redemption price of the Series A Preferred Shares, instead of the peso equivalent of the cost and redemption price of the said shares. In support of its contention, petitioner cites *Section 12 of Revenue Regulation No. 06-06,* to wit:

[11] The CGT is computed as follows: P5,000.00 or 5% on the first P100,000.00, plus P5,977,071.77 or 10% on the excess gain of P59,770,717.67

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$1:40 and sells the same investment at US$102,000 when the US$:₱ 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 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. (Italics supplied)

A careful perusal of the records, however reveals that the transaction between petitioner and CEP II started when petitioner and CEP II executed a Deed of Assignment[12] on November 2000. By virtue of such Deed of Assignment, petitioner invested and wholly subscribed to the increased shares of stock amounting to P11,567,948.00, by assigning to CEP II its shares of stocks in CE Cebu Geothermal Power Company, Inc., consisting of

[12] Exhibit "M"

100,000 common shares of stock with par value of P28.00 and 313,141 Series A preferred shares of stock with a par value of P28.00[13], by way of full payment, when CEP II increased its capital stock on April 23, 2001[14].

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[15], 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 a 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 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.

Considering the foregoing and applying the provisions of *Section 12 of Revenue Regulation No. 06-06,* the computation of the Capital Gains Tax due from petitioner arising from the gain it realized from the redemption by CEP II

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13 Annex "A" of Exhibit "M"
14 Exhibit "K"
15 Exhibit "K-2"

of 187,348 Series A Preferred Shares should be computed using the Philippine peso cost and the Philippine peso selling price, to wit:

Redemption value per share in Philippine Pesos			
	Redemption price per share in US \$	8.59	
	x PDS[16] Closing Rate-May 17, 2005	54.36	466.95
Less: Cost per share in Philippine Pesos			
	Paid-up capital per Philippine Peso Books	1,707,864,702	
	/ No. of shares outstanding	11,587,948	147.38
Capital Gain per share-Philippine Pesos			319.57
No. of shares redeemed			187,348.00
Capital gain – Philippine Pesos			P59,870,717.67[17]

Thus, the amount of Capital Gains Tax paid by petitioner was correct.

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

SO ORDERED.

JUANITO C. CASTAÑEDA, JR.
Associate Justice

WE CONCUR:

ERLINDA P. UY
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

[16] Philippine Dealing System
[17] The correct amount should be P59,870,800.36

ATTESTATION

I attest 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.
Associate Justice
Chairperson

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.

ERNESTO D. ACOSTA
Presiding Justice