REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

KAO (Philippines) Inc.,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent,

C.T.A. CASE No. 4899

Promulgated:
FEB 21 1995

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DECISION

This case is a claim for refund of overpaid creditable withholding tax in the amount of P159,047.00 for the calendar year ended December 31, 1991.

Petitioner Kao Corporation is a domestic corporation duly organized and existing under and by virtue of the laws of the Philippines. It is a wholly owned subsidiary of Kao Corporation of Japan and is engaged in the business of trading household products. One of its sources of income is the rental it receives from its affiliate Pilipinas Kao for the lease of the manufacturing assets used by the latter in producing household products. For the taxable year 1991 Pilipinas Kao as lessee and withholding agent withheld the amount of P225,000.00 out of the P4,500,000.00 rental it allegedly paid to petitioner Kao Corporation (see Exhibit

"B") in compliance with the expanded withholding tax regulation. (Rev. Reg. 6-85, Sec. 1, (c). Petitioner Kao Corporation declared in its income tax return for the year 1991 as part of its gross income the amount of P4,333,333.00 as rental income it received from Pilipinas Kao (Exhibit "C") and indicated in the same return the amount of P225,000.00 as the tax withheld from the rental income (Exhibit "C-1").

In the aforementioned tax return, the income tax due from the petitioner for the taxable year 1991 is in the amount of P65,933.00. This figure was determined after citing the following income received and the deductions allowed for the said year:

INCOME: Schedule I		
Gross sales	P	46,725,477
Schedule 4		
Rental income	P	4,333,333
Schedule 5		
Interest etc.	P	1,750,867
Total:	P	52,809,677
LESS: Deductions	P	52,621,239
Net Income:	P	188,438
Tax Due:	P	65,953

The Creditable tax withheld by lessee in the amount of P225,000 (Exhibit "C") is much more than the tax due of petitioner for the year 1991 thus petitioner contends that there was overpayment of P159,047.00, computed as follows:

1992 Creditable Tax	P	225,000
LESS: Tax Due 1991 ITR	P	65,953
Refundable	P	159,047

There being an alleged overpayment of income tax for the year 1991, petitioner filed a written claim for refund with the respondent on December 15, 1992. On January 3, 1993, barely three weeks from the date he filed his claim which was way ahead of the end of the prescriptive period for claiming a refund and without waiting for the ruling of respondent commissioner, petitioner came to this Court on a petition for review asking that judgment be rendered ordering respondent to grant him a refund of excess Tax payment of P159,047.00

These rental payments which form part of the gross income of petitioner stem from a leasehold agreement between petitioner Kao Corporation as lessor and Pilipinas Kao as lessee of the manufacturing assets owned by the former and used by the latter in producing household goods. The goods manufactured shall then be marketed and sold by Kao Corporation in pursuance of a sales and marketing agreement between the two companies. The contract of lease provides among other things that the annual rental fee for the assets is P6,000,000.00 and shall be payable quarterly on a calendar year basis at the rate of P1,500,000.00. For the year 1991, petitioner declared in its income tax return the amount of P4,333,333.00 as the total amount it received from Pilipinas Kao. Pilipinas Kao as withholding agent and in compliance with Sec. 51 of the Tax Code submitted a certificate of creditable income tax withheld (Form 1743-1) and declared the amount of P225,000.00 as the rate of tax withheld representing 5% of the total amount of P4,500,000.00 it paid to petitioner Kao Corporation for the year 1991.

The only issue presented to this Court for resolution is whether or not petitioner is entitled to a refund of creditable withholding tax in the amount of P159,047.00 for the calendar year ended December 31, 1991.

Petitioner asserts that he is entitled to recover the amount of P159,047.00 it allegedly overpaid as withholding tax at source for the year 1991. He has shown in his petition as well as in his memorandum that there has been strict compliance with all the requirements of the law in validly claiming for a refund.

Respondent maintains otherwise. In her answer, respondent asserts the following special and affirmative defenses:

> 4. Petitioner has failed to state any cause of action under Section 204 of the Tax Code, under which the Commissioner of Internal Revenue allegedly may credit or refund taxes erroneously or illegally received.
>
> 5. In addition, well-settled is the doctrine that provisions or the tax refund are construed strictly against the taxpayer as they are in the nature of tax exemption.
>
> 6. Besides, in an action for refund, the taxpayer has the burden to show that the taxes paid were erroneously or illegally paid and failure to do is fatal to the action for refund.

7. Moreover, and in this case, the claim for refund is still under investigation.

This Court agrees with the petitioner.

In the case of **Citytrust Finance Corporation vs. Commissioner of Internal Revenue,** CTA Case No. 4134, November 11, 1991, this Court had the occasion to cite the following requirements for a valid refund of creditable withholding tax in excess of the amount of the tax due:

> 1) that the claim is filed with the Commissioner of Internal Revenue within the two year period from the date of payment of the tax as required by Section 204 of the Tax Code;
>
> 2) it must be shown on the return of the recipient that the income payment received was declared as part of the gross income, and
>
> 3) the fact of withholding is established by a copy of the statement duly issued by the payor to the payee showing the amount paid and the amount of tax withheld therefrom. (see also Sec. 10, Rev. Reg. 6-85).

The records show that petitioner filed its claim for refund within the two year prescriptive period specified in Art. 204 of the Tax Code. It filed its final income tax return for the taxable year 1991 on April 2, 1992 (Exhibit "C") and filed a written claim for refund on December 15, 1992 (Exhibit "E"). Twenty days later on January 5, 1993, petition for review was filed with this Court.

To further bolster his contention, petitioner presented evidence among others:

Exhibit "A" - lease contract between petitioner and Pilipinas Kao

Exhibit "B" - certificate of withholding tax at source for the year 1991 in the amount of P225,000.00

Exhibit "C" - Petitioner's 1991 ITR filed with the BIR on April 2, 1992

"C-1" - creditable tax withheld P225,000.00

"C-2" - tax payable P65,953.00

"D" - petitioner's financial statement for 1991 issued by Carlos J. Valdez

"E" - letter - claim for refund dated December 15, 1992 and received by the BIR on December 15, 1992

Respondent on his part did not produce evidence to controvert petitioner's claim and opted to submit the case for decision based on the records. Only the petitioner submitted his memorandum.

During the trial, counsel for respondent tried to establish that Kao Philippines and Pilipinas Kao are one and the same company and that the relationship of lessor and lessee was conveniently formed to serve as a tax shelter. However this line of questioning was not pursued as counsel for respondent failed to elicit the kind of response from witness that would strengthen this assertion as can be gleaned from excerpts of the cross examination conducted by counsel for respondent quoted hereunder:

> Q. Miss Witness, during the direct examination, you mentioned that there was a contract of lease between Kao Philippines Inc. and Pilipinas Kao Inc., is that correct?
>
> A. Yes.

Q. And wherein the Kao Philippines, Inc. is the lessor?

A. Yes.

Q. And Pilipinas Kao Inc., as the lessee?

A. Yes.

Q. Aside from the lessor - lessee relationship between Kao Philippines, Inc. and Pilipinas Kao Inc., is there any other relationship between the two companies ?

Atty. Belen (counsel for petitioner)

Objection ; your Honor, its no longer material to the ......

Judge Acosta

Objection overruled.
Please answer the question.

Atty. Belen

Please read back the question.
Question being read back by Court stenographer.

A. None.

Q. Miss Witness, do you have a copy of the articles of incorporation of our company?

A. If I know?

Q. Yes.

A. Yes, I know.

Q. And the stockholders are the same ? Not one stockholder of Pilipinas Kao is also a stockholder of Kao Philippines?

A. I know the stockholder of Kao Philippines.

Q. And they are completely different from the stockholder of Pilipinas Kao ?

Atty. Belen (counsel for petitioner)

Objection again your Honor, immaterial on the issue of refund, your Honor.

Judge Acosta

Could you explain to this Court the relevance of your question ?

Atty. Capunong (counsel for respondent)

Your Honor please, we are trying to establish the credibility of the contract of lease because that is bone of, or the issue in which the refund is being claimed, your Honor.

Judge Acosta

If you can prove that these are one and the same company there is really no ground.

Atty. Capunong

Yes, your Honor.

Judge Acosta

All right, you proceed.
Objection overruled.

A. I know the Kao Philippines.

Atty. Capunong

No further questions, your Honor.

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Moreover, respondent failed to submit evidence to dispute petitioner's claim.

Respondent did not even bother to file any comment on petitioner's formal offer of evidence by way of contesting the evidence as to its veracity, materiality and probative value. Additionally, no memorandum was ever presented to advance his arguments inorder to assist the Court in arriving at an even-handed decision founded on equity and impartiality. It can be inferred from the foregoing circumstances that respondent falls short of the duty required of him in defense of the government, to which he belongs and represents.

We find that the petitioner has successfully established his right to claim for a refund. This Court however cannot award the amount of P159,047.00 as prayed for in the petition because of petitioner's failure to declare the correct rental income in its income tax return which served as the basis for the alleged overpaid amount. A perusal of the said income tax return reveals that petitioner declared only the amount of P4,333,333.00 as rental income for the year 1991, and not P4,500,000.00 as indicated in the certificate of creditable income tax withheld submitted by withholding agent.

This Court has ruled in several cases that claims for tax credit or refund of income tax deducted and withheld on income payments shall be recognized when it is shown on the tax return that the income payment received was declared as part of the gross income and the fact of withholding is established by a copy of the statement duly issued by the payor to the payee showing the amount paid and the amount of tax withheld therefrom, (Rev. Reg. 6-85, Sec 10; **Citytrust Finance Corp. vs. CIR,** CTA Case No. 4134, November 11, 1991; **BPI Savings Bank Inc. vs. CIR,** CTA Case No. 4412 August 17, 1992).

Using the rate specified in the income tax return as rental income, there will be a change in the amount of the refund, thus computed:

Rental Income (as declared in ITR) -	P4,333,333.00
5% Tax withheld -	216,666.65
Less tax due 1991 ITR -	65,953.00
Refundable amount -	P 150,713.65

In view of the foregoing, respondent is hereby ordered to refund or grant a tax credit to petitioner in the amount of P150,713.65 representing overpaid withholding tax for the year 1991.

No pronouncement as to costs.

SO ORDERED.

MANUEL K. GRUBA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

RAMON O. DE VEYRA
Associate Judge

CERTIFICATION

I hereby certify that this decision was reached after due consultation among the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals