REPUBLIC OF THE PHILIPPIN !
COURT OF TAX APPEALS
QUEZON CITY

PHILIPPINE LONG DISTANCE
TELEPHONE COMPANY,
Petitioner,

-versus -

C.T.A. CASE NO. 4375

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

1/7/92

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D E C I S I O N

This is a claim for refund of allegedly erroneously remitted withholding tax on interest corresponding to the portion of the loan financed by Korean Export-Import Bank (KOEXIM Bank) covering the purchase and importation of equipment as per the supply contract originally entered into by Republic Telephone Company with Gold Star Tele-Electric Co., Ltd. (GST) of Korea.

On February 14, 1981, petitioner acquired by purchase the Republic Telephone Company (RETELCO). As a result, petitioner assumed the obligations under which RETELCO was still bound to in a supply contract with Gold-Star Tele-Electric Co., Ltd. (GST) of Korea involving the purchase of various equipment by RETELCO for its expansion/modernization program.

The contract contains the following pertinent covenants:

"Article 2 Prices

> The prices are given in U.S. $ (US Dollar) and cover delivery C & F Manila Port as per INCOTERMS 1953 and ONCOTERMS supplement 1976 and services as will as any taxes, duties, fees or any other charges which may from time to time be levied by the Government of the Country of Origin of the equipment from where the equipment will be exported, BUT DO NOT INCLUDE ANY TAXES, duties, fees or other charges which may be levied outside the Republic of Korea. Such charges if they become due, ARE TO BE BORNE BY RETELCO.
>
> "The prices for equipment and services specified in Annexes 'A' and 'B' shall not exceed the amount of US Dollar Nine Million Seven Hundred Forty Thousand One Hundred Eighty One (US$9,740,181.00) C & F Port of Manila basis. xxx" (Emphasis Supplied.)

RETELCO likewise agreed to pay the GST 90% of the total contracted equipment price, not to exceed US$9,698,321.00, in 21 successive equal semi-annual installments over a 10-year period, commencing 36 months after first delivery date of the contracted equipment.

The principal obligation and its interest, were guaranteed by the Philippine National Bank (PNB) and its subsidiary, National Investment

Development Corporation (NIDC), as follows:

> "Article 3. Payment & Guarantee of Payment
>
> 3.1.3 Payment of Interest
>
> xxx xxx xxx
>
> a) Regular Semi-Annual Interest
>
> RETELCO shall pay GST interest at the rate of Seven Point Seventy Five (7.75) percent p.a. on the outstanding balance of the contracted equipment price, semi-annually, every June 15 and December 15 of each year until the full amount is paid. xxx."
>
> xxx xxx xxx
>
> 3.2 Guarantee of Payment
>
> xxx xxx xxx
>
> 3.2.2 Letter of Guarantee
>
> National Investment and Development Corporation (NIDC) shall issue an irrevocable letter of guarantee in favor of GST within one (1) month from validation of this contract, where the guarantor unconditionally guarantees the payment in full of principal and interest on any of the foregoing promissory notes when and as due in accordance with its terms.
>
> 3.3 Comfort Letter
>
> Within one (1) month after issuance of the NIDC Letter of Guarantee, the Philippine National Bank (PNB) shall issue a Comfort Letter in favor of GST stating that NIDC is a subsidiary of the PNB and committing itself to make capital contribution to NIDC whenever necessary to allow the latter to fully meet its commitment under above Article 3.2.2"

As a consequence of this contract originally between GST and RETELCO, the EXPORT-IMPORT BANK OF KOREA granted GST an export loan to finance importations of RETELCO.

Having bought RETELCO, petitioner paid interest on July 10, 1987, October 13, 1987, February 10, 1988 and July 10, 1988, amounting to US$599,835.39, and remitted to the BIR the 15% withholding tax on the entire interest payment on the loan, including the portion of the contract financed by KOEXIM BANK, in the total amount of P1,864,458.01 (Exhs. "F-Q") inclusive.

Petitioner maintains that the withholding tax on the interest on the portion of the purchase price corresponding to seventy-six (76%) per centum of the loan extended by KOEXIM BANK in the total amount of P1,416,988.09 were erroneously paid and are not taxable in the Philippines. NO serious objections were raised by respondent on the facts of the case and instead raised the following legal issues in his memorandum:

> (1) Petitioner PLDT does not have the legal personality to institute this claim for tax refund considering that the taxes on the interest due the Philippine government are payable by Gold-Star Tele-Electric Co., Ltd., petitioner's creditor

in the Republic of Korea. He cited the case of Commissioner of Internal Revenue vs. Procter and Gamble, Philippine Manufacturing Corporation, G.R. No. 66838 April 15, 1988, 160 SCRA 560, in support of his stand;

(2) Considering that the RP-Korea Tax Treaty was concluded for the purpose of avoiding a double taxation and the prevention of fiscal evasion, petitioner failed to prove that it is entitled to the tax refund for while it paid the 15% withholding tax, nowhere from the records is the proof that its creditor GST has paid the corresponding tax in Korea on the same income that would indubitably show a case of double taxation.

Ultimately, however, the main issue is whether or not petitioner is entitled to a refund of the alleged erroneously paid withholding tax on interest in the light of the provisions of the RP-Korea Tax Treaty in relation to the National Internal Revenue Code. The theory raised by the petitioner leans much on the relevant provisions of the RP-Korea Tax Treaty, specifically on Article 11 which provides:

"Article 11

INTEREST

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

x x x

4. Notwithstanding the provisions of paragraph 2 hereof, interest arising in a Contracting State and paid to a resident

of the other Contracting State shall be taxable only in that other State if the interest is paid in respect of

x x x

ii) a loan made, guaranteed or insured, or a credit extended, guaranteed or insured by

x x x

bb) in the case of Korea, the bank of Korea, the Export-Import Bank of Korea, the Korea Exchange Bank x x x.

5. The term 'interest' as used in this Article means income from debt-claims of every kind, whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures, as well as income assimilated to income from money lent by the taxation laws of the State in which the income arises, including interest on deferred payment sales. x x x"

In effect, double taxation, sought to be avoided by the treaty, allegedly occurs according to petitioner where petitioner pays in the Philippines 15% withholding tax on the interest on the loan extended by the KOEXIM BANK, while the same interest, which are income of the party in Korea, shall also be subject to the corresponding tax in Korea.

The provisions of the RP-Korea Tax Treaty are clear in its import to avoid double taxation by taxing interest on income only once, and that is, only in the other state (Korea), particularly where such interest, as in this case, arises from "a loan guaranteed by the Export-Import Bank of Korea". Seventy-six (76%) of the credit extended by GST to RETELCO (later PLDT) was financed by the KOEXIM BANK. It is this 76% portion which petitioner seeks to be spared from tax in the Philippines as it should be taxed only in Korea under the aforesaid treaty.

While the loan was extended to GST and who therefore appears to be the creditor of RETELCO, it was known by the KOEXIM BANK that the end user would be RETELCO who was importing the equipment for its modernization and expansion. Thus, KOEXIM BANK certified that, "the loan of US$6,623,000.00 has been granted to GST by KOEXIM BANK purposely to finance importations of RETELCO", (later assumed by PLDT) (Exhibit "C", p. 308, CTA Record). This is consistent with the objectives of KOEXIM BANK which was established "to promote the sound development of the Korean economy and economic cooperation with foreign countries through the offering of loans, guarantees and other financial facilities." It also extends credit to foreign governments, banks and corporations for importing goods and technical services from Korea (Exhibit "R", p. 302, CTA Record). In turn, the payment by RETELCO (later PLDT) of the obligation was guaranteed by government institutions as the PNB and the NIDC. Fittingly, respondent admits in his memorandum that "The loan secured from Goldstar Tele-Electric Co., Ltd. was granted/financed by the Export-Import Bank of Korea x x x". Thus, it can be logically established that the RETELCO loan was, in effect, a loan from a Korean government financial institution, the KOEXIM BANK. This settled, we find petitioner's alternative recourse to Section 28 of the National Internal Revenue code to be also well-founded. Section 28 enumerates the exclusions from gross income and among them are:

x x x

(8) Miscellaneous items. -

(A) Income received from their investments in the Philippines in loans, stocks, bonds, or other domestic securities, or from interest on their deposits in banks in the Philippines by (i) foreign governments, (ii) financing institutions owned, controlled, or enjoying refinancing from them, and (iii) international or regional financing institutions established by governments.

Turning on another point, respondent's reliance on the decision in **Commissioner of**

Internal Revenue v. Procter & Gamble PMC, et al. (G.R. No. 66838, 160 SCRA 560) cannot now stand in the light of the Supreme Court's very recent *en banc* resolution (December 2, 1991) on the same case reversing the previous decision of the second division. But let it be emphasized first that the aforesaid case is distinguishable from the present case. Here, the petitioner may be a withholding agent, but more importantly, it was also contractually bound to shoulder and pay for the taxes accruing from the interest on the loan. Under the test offered by petitioner, worthy of note, which is that the real party in interest is the person who has the right to control and receive the fruits of the litigation, it is in fact the petitioner that stands to suffer the loss if this petition is denied or will be entitled to the gain if the result of the petition is otherwise. Therefore, petitioner can be considered a real party in interest in the present case. It appears to us that this test equals the standard on determining a real party in interest propounded in the **Procter and Gamble case** which deemed to include a wholly owned subsidiary withholding agent on the basis that the suhbsidiary (P & G - Phils. is an agent which is the parent-stockholder of P & G - USA). The petitioner in the present case, however, can lay claim to an equal if not more than substantial stake to the fruits of the action, having borne the taxes in the Philippines pursuant to the contract. Verily, petitioner in this case can be considered a "taxpayer" as the term has been expounded in the revised **Procter and Gamble case.**

Neither can we give support to a seeming obstacle being pushed by respondent to bar petitioner's claim which is supposedly the proof of payment by GST of the corresponding tax in Korea. It is not for the respondent to impose administrative interference particularly where treaty commitments between signatory states are involved. Compliance by the other state to its treaty commitment is entitled to as much deference as the compliance by the Philippines. Nowhere is it reflected in the provisions of the subject tax treaty that taxes need be paid by the resident of the other contracting state in said state before tax spareness as promised therein can be claimed. The treaty clearly mandates that "interest arising in a Contracting State and paid to a resident of other Contracting State shall be taxable only in that other State if the interest is paid in respect of x x x a loan made, guarateed or insured by x x x in the case of Korea, x x x the Export-Import Bank of Korea x x x." (Underscoring supplied). In tax treaties between states used to avoid double taxation, the commitment by the parties mainly involved the allowance of a matching credit or tax relief, or reciprocal actions. The conclusion and ratification of the tax treaty is enough to leave an assurance to the parties that the commitment will be honored. The creation of administrative requirements that will not facilitate transactions but instead make for excessive routines will defeat another purpose of tax treaties which is the improvement of commerce. More so, when we take into account the peculiar relationship of the parties incidental to the transaction discussed here which are not in a subsidiary-parent relationship as in the **Procter and Gamble case** but are really separate entities.

Finally it may not be amiss to say that from another angle, petitioner is also correct to infer that if under the relevant provisions of Section 28 of the National Internal Revenue Code income on loans granted by a financial institution of a foreign government such as the KOEXIM BANK is expressly excluded from gross income and exempted from taxation, there is no necessity of showing that such income has been subjected to tax in Korea.

WHEREFORE, judgment is rendered in favor of petitioner. Respondent is hereby ordered to refund or credit to petitioner the amount of P1,416,988.09 erroneously paid as withholding tax on its interest payments.

SO ORDERED.

Quezon City, Metro Manila, January 7, 1992.

ERNESTO D. ACOSTA
Associate Judge

I CONCUR:

CONSTANTE C. ROAQUIN
Associate Judge

CERTIFICATION

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

CONSTANTE C. ROAQUIN
Associate Judge
Court of Tax Appeals