REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
Quezon City

Third Division

LEAH EMPESANDO, ET. AL., *Petitioners,*	**CTA CASE NO. 9093**
-versus-	**Members:** **FABON-VICTORINO,** and **RINGPIS-LIBAN,** ***JJ.***
COMMISSIONER OF INTERNAL REVENUE *Respondent.*	**Promulgated:** SEP 17 2018 10:28 a.m.

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DECISION

RINGPIS-LIBAN, J.:

The Case

Before this Court is a Petition for Review[1] filed by Leah Empesando, Leriza Endriaga, Alberto Enriquez, Natalie Escano, Angela Escudero, Melissa Jane Escurel, Oliver Esguerra, Maria Cecilia Estoque, Ma. Cristina Eusebio, Bebedel Fabe, Laura Falcutilla, Katrina Fano, Nilo Farrofo, Vivien Faulmino, Marilyn Fecara, Esnerjames Fernandez, Ma. Rita Festin, Jasper Florendo, Ralie Flores, Lady Vienne Fong, Kristina Formanes, Myrna Fortu, Maria Milagros Francisco, Esmeralda Fulgentes, Janice Gabriel, Adelita June Gacutan, April Marie Gallega, Lornardo Gallevo, Pamela Jhoanna Gamilla, Noel Gamo, Broderick Dalmacius Garcia, Eufemia Garcia, Luz Garcia, Ma. Socorro Carmela Garcia, Abigail Garrovillas, Raul Ambrosio Gatmaitan, Aileen Gatson, Lamberto Geronimo, Jennifer Go, Jose Frazier Gomez, Katherine Gonzales, Maria Melissa Gregorio, Asuncion Gregorios, Elverie Guanso, Lawrence Nelson Guevarra, Ma. Kristina Guillermo, Philip Gutierrez, Maria Karen Guzman, Maria Rita Habalo, Paulo Rodelio Halili, Ma. Imelda Hamo, Ma. Victoria Harder, Veronica Glady Hari, Carmelia Aurora Hernandez, Edita Hernandez, Louise Margaret Hernandez, Jerome Herradura, Virginia Herrera, Francia Macrina Holgado, Luchi Holganza, Mary Grace Huelgas, Marie Stephanie Igaya, Ana Maria Ignacio,

[1] Docket, vol. I, pp. 14-33.

Leticia Ignacio, Christine Infantado, Jean Claire Inocencio, Kristine Andrea Jamon, Consuelo Javier, Girlie Claire Javier, Marjorie Ann Javillonar, Carlos Jucaban, Rhea Juliano-Casis, Glenda Jurado, Ma. Cynthia Kalingo, Debbie Labarrete, Visitacion Labog, Ma. Victoria Lacastesantos, Regina Ladaban, Luis Antonio Lagdameo, Cristina Lagman, Pamila Lapitan, Noelle Diane Laspinas, Myrna Lavides, Editha Lavina, Nelia Layco, Maria Eloisa Lazo, Karen Lee, Catherine Leonillo, Teresita Leono, Marie Michelle Liboon, Nancy Librada, Geraldine Ligeralde, Maria Carr Cruz Ligutom, Maria Rosalyne Lim, Leonida Limqueco, Cristina Liwag, Ma. Purificacion Liwanag, Edylyn Liwanes, Llona Isabel Llamanzares, Christine Susan Lo, and Jacqueline Lo, collectively praying for the refund of their alleged erroneously paid and illegally collected income taxes for taxable years 2012 and 2013 in the total amount of Php47,751,044.82.

The Facts

Petitioners are all Filipinos and are regular employees of the Asian Development Bank ("ADB") at the time they paid their respective income taxes for taxable years 2012 and 2013.[2]

On the other hand, Respondent is the duly appointed Commissioner of the Bureau of Internal Revenue ("BIR"), who has the power to decide disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties imposed in relation thereto or other matters arising under the National Internal Revenue Code ("NIRC") of 1997, as amended, or other laws or portions thereof administered by the BIR. He holds office at the 5th Floor, BIR National Office Building, Agham Road, Diliman, Quezon City.

Petitioners argue that since the ADB started in 1966 up to 2013, Filipino ADB employees were exempted from payment of income tax on their salaries received from the ADB, pursuant to the Agreement Establishing the Asian Development Bank ("ADB Charter").[3]

However, on April 12, 2013, Respondent issued Revenue Memorandum Circular ("RMC") No. 31-2013 entitled Guidelines on the Taxation of Compensation Income of Philippine Nationals and Alien Individuals Employed by Foreign Governments/Embassies/Diplomatic Missions and International Organizations Situated in the Philippines. It provides, among others, that only the officers and staff of the ADB who are not Philippine nationals shall be exempt from Philippine income tax. The significant provisions are quoted hereunder:

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[2] *Id.,* vol. I, Petition for Review, Par. 2, p. 17; Stipulated Facts, Joint Stipulation of Facts and Issues (JSFI), p. 378.

[3] *Id.,* vol. II, Petitioners' Memorandum with Manifestation, p. 608.

"SECTION 2. *Tax Treatment of Compensation Income.* –

The tax treatment of Philippine nationals and alien individuals **on compensation income received by them from foreign governments/embassies and missions and international organizations shall be as follows:**

xxx xxx xxx

(d) *Those Employed by Organizations Covered by Separate International Agreements or Specific Provisions of Law* –

1. *Asian Development Bank (ADB)*

Section 45 (b), Article XII of the *Agreement between the Asian Development Bank and the Government of the Republic of the Philippines regarding the Headquarters of the Asian Development Bank* provides:

'ARTICLE XII

xxx xxx xxx

Section 45.

Officers and staff of the Bank, including for the purposes of this Article experts and consultants performing missions for the Bank, shall enjoy the following privileges and immunities:

xxx xxx xxx

(b) Exemption from taxation on or in respect of the salaries and emoluments paid by the Bank subject to the power of the Government to tax its nationals;' (*Underscoring supplied*)

> **From the above, only officers and staff of the ADB who are not Philippine nationals shall be exempt from Philippine income tax.**
>
> xxx xxx xxx
>
> SECTION 3. *Filing of Income Tax Returns and Declaration of Compensation Income.* – **Philippine nationals and alien individuals who were not granted tax exemption or immunities under duly recognized international agreements or local laws shall file their annual income tax returns** on or before the 15th day of April each year using BIR Form No. 1700 or 1701, as may be applicable, **declaring therein the amount of their respective compensation income for the preceding taxable year for the services rendered or performed for such foreign government embassy/diplomatic mission, agency or international organization.**
>
> The annual income tax return shall be filed with the Revenue District Office, Authorized Agent bank, or other proper office which has jurisdiction over the employee's legal residence or principal place of business. It may also be filed with the Revenue District Office or Authorized Agent bank where the principal office of his/her employer is situated." *(Emphasis supplied)*

In compliance with RMC No. 31-2013, which was given retroactive application, Petitioners paid their respective income taxes for their 2012 and 2013 salaries.[4]

Believing that RMC No. 31-2013 was issued *ultra vires*, two Filipino ADB employees questioned its legality before the Regional Trial Court ("RTC") Branch 213 of Mandaluyong City, docketed as *Erwin Salaveria et al. vs. Commissioner of Internal Revenue*, Civil Case No. MC14-8775.

On September 30, 2014, the RTC promulgated its decision in Civil Case No. MC14-8775 declaring Section 2(d)(1) of RMC No. 31-2013 as void for being issued without legal basis, in excess of authority and/or without due process of law, and in the absence of legislation and/or regulation to the contrary.[5] A Motion for Reconsideration was filed by Respondent, but it was denied on January 09, 2015.

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[4] *Id.,* vols. I and II, Exhibits "P-4" to "P-23", inclusive of sub-markings, pp. 313-353, 479-482, 492, 494-496, 498, and 501-527.

[5] *Id.,* vol. II, Exhibit "P-24", pp. 528-559.

Respondent appealed the lower court decision to the Court of Appeals, docketed as CA-G.R. CV No. 104374, which dismissed it *via* Resolution dated July 03, 2015. Subsequently, Respondent filed a Motion for Reconsideration, but it was also denied by the Court of Appeals.[6]

Respondent then elevated the case before the Supreme Court by filing a Petition for Review on *Certiorari*. The case is still pending resolution by the High Court.

Armed with the favorable decision of the RTC, Petitioners filed administrative claims for refund with the BIR on June 22, 2015 and June 30, 2015.[7] The judicial claim was filed before this Court on July 14, 2015.[8]

Respondent filed his Answer[9] on September 07, 2015, interposing the following arguments and special and affirmative defenses:

> "Respondent contends that Petitioners being Filipino citizens and residents of the Republic of the Philippines are subject to the Philippine Income Tax;
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> Sections 23 and 22(E) of the National Internal Revenue Code of 1997, as amended, specifically states:
>
> > '***Sec. 23. General Principles of Income Taxation in the Philippines.*** – *Except when otherwise provided in this Code:*
> >
> > *(A) A citizen of the Philippines residing therein is taxable on all income derived from sources within and without the Philippines; xxx'*
> >
> > '***Section 22. Definitions.*** – *When used in this Title:*
> >
> > *xxx xxx xxx*

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[6] *Id.,* vol. II, Exhibits "P-25" and "P-25-1", pp. 560-571.
[7] *Id.,* vol. I, Exhibits "P-2" and "P-3", pp. 291-312.
[8] *Id.,* vol. I, Petition for Review, p. 14.
[9] *Id.,* vol. I, pp. 209-219.

(E) The term 'nonresident citizen means:

(1) A citizen of the Philippines who establishes to the satisfaction of the Commissioner the fact of his physical presence abroad with a definite intention to reside therein.

(2) A citizen of the Philippines who leave the Philippines during the taxable year to reside abroad, either as immigrant or for employment on a permanent basis.

(3) A citizen of the Philippines who works and derives income from abroad and whose employment thereat requires him to be physically present abroad most of the time during the taxable year.

(4) A citizen who has been previously considered as nonresident citizen and who arrives in the Philippines at any time during the taxable year to reside permanently in the Philippines shall likewise be treated as nonresident citizen for the taxable year in which he arrives in the Philippines with respect to his income derived from sources abroad until the date of his arrival in the Philippines.

(5) The taxpayer shall submit proof of the Commissioner to show his intention of leaving the Philippines to reside permanently abroad or to return to and reside in the Philippines as the case may be for purposes of this Section.'

Taxation of income in the Philippines is based on Citizenship, Residency and the Source Principle;

Under the *Citizenship principle*, the basis of the imposition of income tax is the taxpayer's citizenship. All citizens of the Philippines, whether resident or non-resident, are subject to our income tax law. In the case of resident citizens, they are subject to income tax derived from within and without the Philippines, while non-resident citizens are only subject to the income tax on the income derived from within the Philippines.

Under the *Residence principle*, the basis of the imposition of all income tax in this case is the residence of the taxpayer. All income derived by persons residing in the Philippines, whether citizens or aliens, whether domestic corporations or foreign corporations, shall be subject to income tax on the income derived from sources within the Philippines.

Under the *Source Principle*, the basis of the imposition of income tax is the source of the income. All income derived from sources within the Philippines shall be subject to income tax. Thus, even nonresident citizens or aliens and foreign corporation who derive income from within the country are subject to income tax. This also follows the territoriality principle.

Petitioners are Filipino citizens and employees of the Asian Development Bank, with business address at ADB Avenue, Ortigas Center, Pasig City. There is no doubt that Petitioners are liable for income tax on the compensation income they earned on account of such employment.

When the ADB Charter was created in 1965, it was expressly stated in Article 54 on Exemption from Taxation that:

> *'No tax shall be levied on or in respect of salaries and emoluments paid by the Bank to Directors, alternates, officers or employees of the Bank, except where a member deposits with its instruments of ratification or acceptance a declaration that such member retains for itself and its political subdivisions the right to tax salaries and emoluments paid by the Bank to citizens or nationals of such member.'*

In signing the ADB Headquarters Agreements in 1956, the Philippine government accorded tax exemption privileges to the ADB and its staff, but held on to the State's inherent power to tax, and thus made a clear limitation in so far as its right to tax its nationals. Hence, Section 45(b), Article XII of the ADB Headquarters Agreement provides that:

> *'Article XII*
> *PRIVILEGES AND IMMUNITIES OF GOVERNORS AND OTHER REPRESENTATIVES OF MEMBERS, DIRECTORS, PRESIDENT, VICE-PRESIDENT AND OTHERS*
>
> *Section 45*
> *Officers and staff of the Bank, including for the purposes of this Article experts and consultants performing missions for Bank, shall enjoy the following privileges and immunities:*

N/

xxx

(b) Exemptions from taxation on or in respect of the salaries and emoluments paid by the Bank subject to the power of the Government to tax its nationals; xxxx'

In the same year, the Philippine Congress issued Resolution No. 06 to the effect that 'the Senate of the Philippines concurs, as it hereby concurs, in the ratification by the President of the Philippines of the aforesaid Agreement Establishing the Asian Development Bank, subject to the ***reservation*** that the Philippines declares that it retains for itself and its political subdivisions the right to tax salaries and emoluments paid by the Bank to its citizens or nationals of the Philippines pursuant to Article 56, paragraph 2, of the Agreement' *(Underscoring supplied)*

Explicit from the foregoing is that the Philippines, by making a 'reservation', simply intimated that in entering upon an Agreement with ADB the only effect is that the income of ADB is exempt from tax by virtue of the Agreement but not the income derived by the Filipinos from ADB;

Petitioners may claim that the coverage of the Article XII of 'Headquarters Agreement' only concerns the privileges and immunities of the higher officials of the ADB. Such contention is utterly misplaced since the title of the Article itself did not restrict the application of the said Article of ADB's higher officials only, to wit: PRIVILEGES AND IMMUNITIES OF GOVERNOR'S AND OTHER REPRESENTATIVES OF MEMBERS, DIRECTORS, PRESIDENT, VICE-PRESIDENT AND OTHERS;

Moreover, the above-quoted Section 45 of the said Article referred to Officers and Staff of the bank as well;

BIR ITAD Ruling further states that there is no need for an executing law to implement the 'Reservation' because Philippine tax law already provides that Filipinos are liable for tax from income derived from within and without the Philippines;

The construction of the word 'Reservation' can only be accorded its plain meaning if, before the Philippines entered into the Agreement with ADB, Filipinos earning income from without the Philippines have no obligation to pay taxes in the Philippines. Since 1939, Filipinos earning income derived from outside the Philippines are liable for tax from such income. This is true when one considers Section 37 in relation to Section 45 of the Internal Revenue Code of 1939, Section 21 in relation to Section 27 of the National Internal Revenue Code of 1997, and Section 24 in relation to Section 51 of the National Internal Revenue Code of 1997;

To accord the word 'reservation' with an ordinary meaning will undermine the force of existing tax laws. Thus, a contrary interpretation would mean subverting Philippine sovereignty by virtue of a mere Agreement just for the purpose of exempting some Filipinos from income tax. While international comity is laudable and a Constitutional requirement, the power to tax is an inherent power of the State that cannot be bargained away so easily;

Same BIR ITAD Ruling added that the ADB Charter is not a law, but an agreement among Contracting States. That being the case, it is a derogatory interpretation that exempting from tax includes exemption from tax of Filipino citizens without express mention of Filipino exemption;

Pacta sunt servanda and international comity dictate that the Philippines should honor its international agreements in good faith. The Philippines has arguably complied with these principles of international law by according the proper concessions and tax breaks to ADB activities. This duty ends where the concern is a domestic matter involving the taxability of the income of its citizens. The ADB Charter was never amended by subsequent Philippine tax laws, because Philippine tax laws before and after the creation of ADB imposed taxes on income of Filipinos from within and without the Philippines.

Petitioners may contend that subsequent practice, as regards the ADB charter, is non-taxability of the income of its employees, arguing that ADB employees have never been subjected by the taxing authority ever since the Philippines' ratification of the ADB Charter. They insist that an operative act is required to change the norm followed after the ratification of the ADB Charter;

It is as if Petitioners would like this Honorable Court to treat such subsequent practice into a custom which is recognized source law. It is a standard rule that customs which are contrary to law shall not be countenanced;

In the case of *Malang vs. Moson*, the Supreme Court significantly held that:

> *'The Court is duty-bound to resolve that the instant case applying such laws and rights as are in existence at the time the pertinent civil acts took place, and is unable to supplant governing law with customs, albeit how widely observed.'*

RMC 31-2013 is only a clarification of existing policies already in the Philippine law. Thus, this alleged subsequent practice, which is contrary to existing law, cannot in any way displace what the law had provided from the start;

RMC 13-2012 *[sic]* is valid because it is only a mere clarification of existing policies embodied in the law;

As stated in BIR ITAD Ruling No. 018-14, the 'Reservation' made by the Philippines regarding its right to tax its citizen who earn income as employees of ADB is not a mere reservation but an affirmation of the inherent power of the State to tax its own citizens;

Petitioners anchor their claim that they are exempted from income tax on the provisions of Revenue Memorandum Order No. 31-2013 which provides:

xxx

> *(d) Those Employed by Organizations Covered by Separate International Agreements or Specific Provision of Law –*
>
> *1. Asian Development Bank (ADB)*
>
> *Section 45(b), Article XII of the Agreement between the Asian Development Bank and the Government of the*

Republic of the Philippines regarding the Headquarters of the Asian Development Bank provides:

'Article XII

xxx

Section 45

Officers and staff of the Bank, including for the purposes of this Article experts and consultants performing missions for the Bank, shall enjoy the following privileges and immunities:

xxx

(b) Exemption from taxation on or in respect of the salaries and emoluments paid by the Bank subject to the power of the Government to tax its nationals;

From the above, only officers and staff of the ADB who are not Philippine nationals shall be exempt from Philippine income tax.

Petitioners claim that they are exempt from the payment of income tax has no legal basis. Under the above-cited revenue issuance, it is clear that the exemption is still subject to the power of the Government to tax its nationals, including the herein Petitioners. Thus, reverting to the earlier discussion, Section 23, in relation to Section 24 of the National Internal Revenue Code of 1997, as amended, are the laws on the matter. As previously submitted, Petitioners, being Filipino citizens and nationals are taxable from their income within and outside the Philippines;

Petitioners must prove that they were able to comply with the following documentary and legal requirements as provided under Section 229 of the 1997 National Internal Revenue Code, as amended, to wit:

1. That the taxpayer should file a written claim for refund or tax credit with the BIR Commissioner within two (2) years from the date of payment of the tax or penalty, non-compliance with

which the latter is precluded from exercising his authority thereon;

2. That if denied or not acted upon within said period, the petition for refund be filed with the CTA within 30 days from the receipt of the denial AND within said two (2) year period from the date of payment of the tax or penalty regardless of any supervening cause, otherwise, the claim for refund shall have prescribed;

3. The claim for refund must be a categorical demand for reimbursement;

4. There must be a proof or payment of the erroneously or illegally collected taxes; and

5. No refund shall be given resulting from availment of incentives granted pursuant to special laws for which no actual payment was made.

Petitioners must prove that their income is not taxable or exempt from income tax;

Petitioners must provide the basis for the alleged tax exemptions;

Tax exemptions are never presumed and are strictly construed against the taxpayer and liberally in favor of the taxing authority. They can only be given force when the grant is clear and categorical. The surrender of the power to tax, when claimed must be clearly shown by a language that will admit of no reasonable construction consistent with the reservation of the power. If the intention of the legislature is open to doubt, then the intention of the legislature must be resolved in favor of the State. (*Smart Communications, Inc. vs. The City of Davao, et al G.R. No. 155491*)

A tax refund is in the nature of a tax exemption which must be construed *strictissimi juris* against the taxpayer. The taxpayer must present convincing evidence to substantiate a claim for refund. (*FEBTC vs. CIR, G.R. No. 149589, September 16, 2006*)

In the case of *CIR vs. Rosemarie Acosta, G.R. 154068 dated August 3, 2007*, the Honorable Supreme Court ruled, to wit:

> *'As tax refunds involve a return of revenue from the government, the claimant must show indubitably the specific provision of law from which her right arises, it cannot be allowed to exist upon a mere vague implication or inference nor can it be extended beyond the ordinary and reasonable intendment of the language actually used by the legislature in granting the refund. To repeat, strict compliance with the conditions imposed for the return of revenue collected is a doctrine consistently applied in this jurisdiction.'*

SPECIAL AND AFFIRMATIVE DEFENSES

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10. The Honorable Court has no jurisdiction on the Petition. Herein Petitioners failed to file the instant claim for refund within the two year prescriptive period.

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11. Granting without admitting that the Honorable Court has jurisdiction, the alleged decision of RTC Branch 213 from which Petitioners based their claim for refund is void. The same was issued by a regular court that has no jurisdiction to take cognizance of the case relating to the validity of Revenue Memorandum No. 31-2013 (RMC 31-2013). The power to rule on the validity of Revenue Issuances administered by the BIR are within the jurisdiction of the Court of Tax Appeals and not the Regular Courts.

As discussed in the preceding paragraphs, the Supreme Court held in the case of *The Philippine American Life and General Insurance Company v. The Secretary of Finance and the Commissioner of Internal Revenue*, that:

> Evidently, the *City of Manila* can be considered as departure from *Ursal* in that in spite of there being no express grant in law, the CTA is deemed granted with powers of certiorari by implication. Moreover,

> *City of Manila* diametrically opposes *British American Tobacco* to the effect that it is now within the power of the CTA, through its power of certiorari, to rule on the validity of a particular administrative rule or regulation so long as it is within its appellate jurisdiction. **Hence, it can now rule not only on the propriety of an assessment or tax treatment of a certain transaction but also on the validity of the revenue regulation or revenue memorandum circular on which the said assessment is based.**"

The pre-trial conference was held on July 19, 2016.[10] Thereafter, Petitioners and Respondent filed their Joint Stipulation of Facts and Issues[11] on August 03, 2016.

On August 12, 2016, the Court issued the Pre-Trial Order[12] and terminated the pre-trial conference.

Petitioners presented Atty. Peter Paul S. Romero, who testified before the Court on October 24, 2016[13] and identified his Judicial Affidavit[14].

Petitioners then filed their Formal Offer of Evidence[15] on April 21, 2017. In a Resolution[16] dated May 26, 2017, the Court admitted all of Petitioners' exhibits.

During the hearing set for Respondent's presentation of evidence, Respondent, through counsel, manifested that he has no Audit Report and therefore would no longer present evidence. The Court granted the parties thirty (30) days from notice within which to submit their respective memoranda.[17]

Respondent filed his Memorandum on September 27, 2017; while Petitioners filed their Memorandum with Manifestation on October 4, 2017. Hence, the case was submitted for decision on October 10, 2017.[18]

<u>The Issue</u>

[10] *Id.,* vol. I, Minutes of the Hearing, p. 364.
[11] *Id.,* vol. I, pp. 378-381.
[12] *Id.,* vol. I, pp. 387-395.
[13] *Id.,* vol. I, Minutes of the Hearing, p. 407.
[14] *Id.,* vol. I, pp. 283-290.
[15] *Id.,* vol. I, pp. 451-478.
[16] *Id.,* vol. II, pp. 575-576.
[17] *Id.,* vol. II, Minutes of the Hearing, p. 581.
[18] *Id.,* vol. II, p. 621.

The lone issue to be resolved is whether not Petitioners are entitled to claim refund for income taxes paid in taxable years 2012 and 2013 alleged to be erroneously or illegally paid.[19]

Discussion/Ruling

The claim for refund was timely filed.

Before addressing the stipulated issue, the Court shall first determine the timeliness of the filing of the refund claim. Section 229 of the NIRC of 1997, as amended, and Section 3(a)(2) of the Revised Rules of the Court of Tax Appeals provide:

> "SEC. 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 therefor, 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." *(Emphasis supplied)*
>
> "SEC. 3. *Cases within the jurisdiction of the Court in Division.* – The Court in Division shall exercise:
>
> (a) **Exclusive original over or appellate jurisdiction to review by appeal** the following:

[19] *Id.*, vol. I, Issue, JSFI, p. 378.

xxx xxx xxx

> (2) **Inaction by the Commissioner of Internal Revenue in cases involving** disputed assessments, **refunds of internal revenue taxes fees or other charges**, penalties in relation thereto, or other matters arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue, where the National Internal Revenue Code or other applicable law provides a specific period for action: *Provided*, that in case of disputed assessments, the inaction of the Commissioner of Internal Revenue within the one hundred eighty day-period under Section 228 of the National Internal Revenue Code shall be deemed a denial for purposes of allowing the taxpayer to appeal his case to the court and does not necessarily constitute a formal decision of the Commissioner of Internal Revenue on the tax case; *Provided further*, that should the taxpayer opt to await the final decision of the Commissioner of Internal Revenue on the disputed assessments beyond the one hundred eighty day-period above-mentioned, the taxpayer may appeal such final decision to the Court under Section 3(a), Rule 8 of these Rules; and *Provided, still further*, **that in the case of claims for refund of taxes erroneously or illegally collected, the taxpayer must file a petition for review with the Court prior to the expiration of the two-year period under Section 229 of the National Internal Revenue Code**;" *(Emphasis supplied)*

Petitioners paid their respective income taxes for 2012 on July 15, 2013. The administrative claims for refund were filed on June 22, 2015 and on June 30, 2015; while the instant petition was filed on July 14, 2015. Clearly, both the administrative and the judicial claims for refund were filed within the two-year prescriptive period mandated by the above-mentioned provisions.

Resident citizens are subject to the graduated scale of income tax in accordance with Section 24(A) of the NIRC of 1997, as amended, unless specifically exempted therefrom under treaty.

The Court shall now proceed to review the applicable treaty and legislative provisions addressing the tax treatment of income of Petitioners as employees of the ADB.

The ADB Charter was executed on December 04, 1965, which included the following provisions:

> "Article 56
> EXEMPTION FROM TAXATION
>
> 1. The Bank, its assets, property, income and its operations and transactions, shall be exempt from all taxation and from all customs duties. The Bank shall also be exempt from any obligation for the payment, withholding or collection of any tax or duty.
>
> 2. **No tax shall be levied on or in respect of salaries and emoluments paid by the Bank to Directors, alternates, officers or employees of the Bank**, including experts performing missions for the Bank, **except where a member deposits with its instrument of ratification or acceptance a declaration that such member retains for itself and its political subdivisions the right to tax salaries and emoluments paid by the Bank to citizens or nationals of such member.**" *(Emphasis supplied)*

Thereafter, in Senate Resolution No. 6 dated March 16, 1966, the ADB Charter was ratified and confirmed by the Philippine Government with a reservation of its right to tax the Filipino employees of the ADB, to wit:

> "NOW THEREFORE, be it known that I, FERDINAND E. MARCOS, President of the Republic of the Philippines, having seen and considered the Agreement Establishing the Asian Development Bank done on December 4, 1965 at Manila, Philippines, do hereby in pursuance of the aforesaid concurrent of the Senate of the Philippines, ratify and confirm the said Agreement and every article and clause thereof, **subject to the reservation that the Philippines declares that it retains for itself and its political subdivision the right to tax salaries and emoluments paid by the Bank to citizens or nationals of the Philippines**." *(Emphasis supplied)*

On December 22, 1966, the "Agreement Between the Asian Development Bank and the Government of the Republic of the Philippines Regarding the Headquarters of the Asian Development Bank" ("ADB Headquarters Agreement") was signed, and included a similar provision recognizing the right of the Philippine Government to tax Filipino ADB employees, in this wise:

"ARTICLE XII
Privileges and Immunities of Governors and Other Representatives of Members, Directors, President, Vice-President and Others

xxx xxx xxx

Section 45.

Officers and staff of the Bank, including for the purposes of this Article experts and consultants performing missions for the Bank, **shall enjoy the following privileges and immunities**:

(a) Immunity from legal process with respect to acts performed by them in their official capacity except when the Bank waives the immunity;

(b) **Exemption from taxation** on or in respect of the salaries and emoluments paid by the Bank **subject to the power of the Government to tax its nationals** xxx." *(Emphasis supplied)*

Clearly, the ADB Charter provides a tax exemption provision with respect to the salaries and emoluments paid by the ADB to its officers and employees, but the same also contains a proviso wherein a member-country, like the Philippines, may opt to retain its right to tax the salaries and emoluments paid by the ADB to its citizens or nationals. If the Philippine Government intended to exempt the salaries or emoluments that its citizens or nationals would receive from the ADB from income tax, a full ratification of the ADB Charter could have been made, without retaining its right to tax its citizens or nationals.

Basic is the rule in statutory construction that every part of the statute must be interpreted with reference to the context, *i.e.*, that every part of the statute considered together with the other parts, and kept subservient to the general intent of the whole enactment. Because the law must not be read in truncated parts, its provisions must be read in relation to the whole law. The statute's clauses and phrases must not, consequently, be taken as detached and isolated expressions, but the whole and every part thereof must be considered in fixing the meaning of any of its parts in order to produce a harmonious whole.[20]

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[20] *Commissioner of Internal Revenue vs. Pilipinas Shell Petroleum Corporation*, G.R. No. 192398, September 29, 2014.

Accordingly, the exemption granted to officers and employees of the ADB pursuant to the ADB Charter and the ADB Headquarters Agreement must not be read in isolation as there is a *proviso* subjecting Philippine nationals to tax imposed by the Philippine Government on income received from the bank.

Moreover, the NIRC of 1997, as amended, a subsequent legislation which took effect on January 1, 1998, enables or enforces the reservation clauses found in Senate Resolution No. 6 and Section 45(b) of the ADB Headquarters Agreement. Sections 23(A) and 24(A)(1)(a) of the NIRC of 1997, as amended, leave no room for doubt that resident citizens are subject to tax on income derived from all sources within and without the Philippines, to wit:

> "SEC. 23. *General Principles of Income Taxation in the Philippines.* – Except when otherwise provided in this Code:
>
> (A) **A Citizen of the Philippines residing therein is taxable on all income derived from sources within and without the Philippines;**
>
> xxx xxx xxx
>
> SEC. 24. *Income Tax Rates.* –
>
> (A) *Rates of Income Tax on Individual Citizen and Individual Resident Alien of the Philippines.* –
>
> (1) An income tax is hereby imposed:
>
> (a) On the taxable income defined in Section 31 of this Code, other than income subject to tax under Subsections (B), (C) and (D) of this Section, derived for each taxable year **from all sources within and without the Philippines by every individual citizen of the Philippines residing therein;**" *(Emphasis supplied)*

Apparently, the above-quoted provisions impose tax on the income of resident individual citizens from all sources within and without the Philippines. In the absence of a specific grant of tax-exemption, the salaries and emoluments received by Filipino employees of the ADB are subject to income tax. Therefore, Petitioners' income tax payments for salaries and emoluments received from the ADB for taxable years 2012 and 2013 were not erroneously paid and/or illegally collected by the BIR. As a result, such income tax payments cannot be refunded.

While such exemption or non-payment of income tax had been the practice up until the issuance of RMC No. 31-2013, the failure of the BIR to collect income tax from Filipino ADB employees before does not justify the non-implementation of existing legislations nor should result in the absurd construction that tax laws are deemed repealed

Having settled the basis for the imposition of income tax on Petitioners' compensation from the ADB, the Court will now discuss the propriety of enforcing RMC No. 31-13 to Petitioners' income from the ADB for taxable years 2012 and 2013.

While RMC No. 31-13 is a mere interpretation of an existing law, justice and equity dictate that it should be applied prospectively. Income of resident citizens employed by foreign governments and for international organizations should be subjected to income tax beginning taxable year 2013.

RMC No. 31-13 was issued by Respondent in 2013. Nevertheless, Respondent sought to subject Petitioners income for 2012 and 2013 to income tax. In the past, however, compensation income of resident citizens employed by foreign governments and/or international organizations were not subjected to income tax.

While it can be argued that RMC No. 31-13 is a mere interpretation of existing law and should thus be applied even to the compensation income of petitioners for taxable year 2012, the Court holds that it should be applied prospectively in the interest of justice and equity. Consequently, the income of resident citizens employed by foreign governments and/or international organizations should only be subjected to income tax beginning taxable year 2013, the year RMC No. 31-13 took effect.

In the present case, Petitioners who received the compensation income during 2012 were of the honest belief - and neither did Respondent enforce rules to the contrary - that their compensation income were exempt from tax. When Respondent issued RMC No. 31-13 and sought to enforce its provisions subjecting compensation income of resident citizens employed by ADB to the graduated income tax rates immediately, Petitioners were constrained to file their Income Tax Return for 2012 and pay their deficiency tax liabilities in one payment. Whereas previously, their income was not subjected to tax, they now had to come up a substantial amount for an individual in order to settle their income tax liability. Hence, it would be in keeping with justice and equity for the implementation of RMC No. 31-13 to begin prospectively and to apply to compensation income earned by Petitioners beginning taxable year 2013.

Petitioners who have proven their income tax payments for taxable year 2012 may be refunded.

In sum, compensation income of resident citizens is subject to the graduated income tax rates unless expressly exempted under treaty. With the Philippines' reservation in the ADB Charter to the effect that it maintains the right to subject to income tax the compensation of resident citizens employed by the ADB, the rule then is that resident citizens employed by foreign governments and/or international organizations, such as ADB, are subject to the graduated income tax rates under Section 24(A) of the NIRC of 1997, as amended. However, considering RMC No 31-13 was issued in taxable year 2013, the same should be made to apply prospectively in the interest of justice and equity. Hence, compensation income of resident citizens employed by foreign governments and/or international organizations shall only be subject to income tax beginning taxable year 2013, while those income payments made for taxable year 2012 shall be refunded.

Petitioners, who are all Filipinos and regular employees of the ADB allegedly paid income taxes for CY 2012 in the total amount of Php31,893,754.82. In support thereof, petitioners submitted Certifications[21] from the BIR Revenue Accounting Division (RAD) and Annual Income Tax Returns[22] with attached Payment Slips and Revenue Official Receipts.

A careful examination of these documents shows that out of the total claim of Php31,893,754.82, only the amount of Php31,186,136.47 was properly substantiated while the remaining amount of Php707,618.35 is unsupported, detailed as follows:

PETITIONER	PER CLAIM		WITH PROPER SUPPORTING DOCUMENTS		UNSUPPORTED
	DATE OF PAYMENT	INCOME TAX PAID	EXHIBIT	INCOME TAX PAID	
EMPENSANDO, LEAH VI G.	15-Jul-13	Php173,432.99	"P-6-1"	Php173,432.99	Php0.00
ENDRIGA, LERIZA V.	15-Jul-13	260,912.16	"P-6-2"	260,912.16	0.00
ENRIQUEZ, ALBERTO III C.	15-Jul-13	201,767.13	"P-6-3"	201,767.13	0.00

[21] Exhibits "P-4" to "P-12", Docket, Vol. 1, pp. 313-332, 352-363, 479-493, 498-500 and Exhibit "P-13", Docket, Vol. 2, p. 501.

[22] Exhibits "P-14-1" TO "P-14-3", "P-15", "P-16" to "P-16-1", "P-17" to "P-17-1" and "P-18", Docket, Vol. 2, pp. 502-520.

ESCAÑO, NATALIE S.	15-Jul-13	131,234.80	"P-6-4"	131,234.80	0.00
ESCUDERO, ANGELA KRISTINE B.	15-Jul-13	172,924.75	"P-6-5"	172,924.75	0.00
ESCUREL, MELISSA JANE Y.	15-Jul-13	253,048.18	"P-6-6"	253,048.18	0.00
ESGUERRA, OLIVER L.	15-Jul-13	472,766.84	"P-6-7"	472,766.84	0.00
ESTOQUE, MARIA CECILIA D.	15-Jul-13	191,409.79	"P-6-8"	191,409.79	0.00
EUSEBIO, MA. CRISTINA O.	15-Jul-13	564,514.85	"P-6-9"	564,514.85	0.00
FABE, BEBEDEL V.	15-Jul-13	401,399.08	"P-9-1"	401,399.08	0.00
FALCUTILA, LAURA O.	15-Jul-13	337,526.84	"P-9-2"	337,526.84	0.00
FANO, KATRINA M.	15-Jul-13	296,195.47	"P-9-3"	296,195.47	0.00
FARROFO, NILO F.	15-Jul-13	313,095.89	"P-9-4"	313,095.89	0.00
FAULMINO, VIVIAN A.	15-Jul-13	383,357.92	"P-9-5"	383,357.92	0.00
FECARA, MARILYN O.	15-Jul-13	159,344.58	"P-16-1"	159,344.58	0.00
FERNANDEZ, ESNERJAMES P.	15-Jul-13	205,041.24	"P-9-6"	205,041.24	0.00
FESTIN, MARIA RITA R.	15-Jul-13	644,920.77	"P-9-7"	644,920.77	0.00
FLORENDO, JASPER ESTEBAN	15-Jul-13	308,944.49	"P-9-8"	308,944.49	0.00
FLORES, RALIE DUSSELDORF L.	15-Jul-13	161,098.60	"P-9-9"	161,098.60	0.00
FONG, LADY VIENNE C.	15-Jul-13	101,006.22	"P-9-10"	101,006.22	0.00
FORMANES, KRISTINA M.	15-Jul-13	161,463.34	"P-9-11"	161,463.34	0.00
FORTU, MYRNA M.	15-Jul-13	128,738.30	"P-9-12"	128,738.30	0.00
FRANCISCO, MARIA MILAGROS M.	15-Jul-13	156,222.81	"P-9-13"	156,222.81	0.00
FULGENTES, ESMERALDA G.	15-Jul-13	108,398.34	"P-9-14"	108,398.34	0.00
GABRIEL, JANICE J.	15-Jul-13	176,711.59	"P-9-15"	176,711.59	0.00
GACUTAN, ADELITA JUNE	15-Jul-13	217,986.74	"P-9-16"	217,986.74	0.00
GALLEGA, APRIL-MARIE DM.	15-Jul-13	155,588.16	"P-9-17"	155,588.16	0.00
GALLEVO, LORNARDO C.	15-Jul-13	748,723.37	"P-9-18"	748,723.37	0.00
GAMILLA, PAMELA JHOANNA N.	15-Jul-13	267,933.40	"P-9-19"	267,933.40	0.00
GAMO, NOEL S.	15-Jul-13	299,907.84	"P-9-20"	299,907.84	0.00
GARCIA, BRODERICK DALMACIUS B.	15-Jul-13	399,468.33	"P-9-21"	399,468.33	0.00
GARCIA, EUFEMIA	15-Jul-13	425,814.01	"P-9-22"	425,814.01	0.00
GARCIA, LUZ R.	15-Jul-13	904,928.83	"P-9-23"	904,928.83	0.00
GARCIA, MA. SOCORRO CARMELA S.	15-Jul-13	416,970.36	"P-9-24"	416,970.36	0.00
GARROVILLAS, ABIGAIL D.	15-Jul-13	341,987.10	"P-9-25"	341,987.10	0.00
GATMAITAN, RAUL AMBROSIO F.	15-Jul-13	215,180.59	"P-9-26"	215,180.59	0.00
GATSON, AILEEN R.	15-Jul-13	144,343.26	"P-9-27"	144,343.26	0.00
GERONIMO, LAMBERTO S.	15-Jul-13	399,357.41	"P-17-1"	399,357.41	0.00
GO, JENNIFER M.	15-Jul-13	211,833.06	"P-9-28"	211,833.06	0.00

GOMEZ, JOSE FRAZIER P.	15-Jul-13	736,926.77	"P-13-1", "P-13-2"	736,926.77	0.00
GONZALEZ, KATHERINE E.	15-Jul-13	122,652.78	"P-9-29"	122,652.78	0.00
GREGORIO, MARIA MELISSA	15-Jul-13	158,164.55	"P-9-30"	158,164.55	0.00
GREGORIOS, ASUNCION C.	15-Jul-13	375,098.57	"P-9-31"	375,098.57	0.00
GUANSO, ELVERIE S.	15-Jul-13	181,276.00	"P-9-32"	181,276.00	0.00
GUEVARA, LAWRENCE NELSON C.	15-Jul-13	371,430.81	"P-9-33"	371,430.81	0.00
GUILLERMO, MA. KRISTINA B.	15-Jul-13	372,779.74	"P-9-34"	372,779.74	0.00
GUTIERREZ, PHILIP D.	15-Jul-13	426,187.12	"P-9-35"	426,187.12	0.00
GUZMAN, MA. KAREN R.	15-Jul-13	445,940.66	"P-9-36"	445,940.66	0.00
HABALO, MARIA RITA G.	15-Jul-13	454,074.25	"P-7-1"	454,074.25	0.00
HALILI, PAULO RODELIO M.	15-Jul-13	148,498.45	"P-7-2"	148,498.45	0.00
HAMO, MARIA IMELDA M.	15-Jul-13	343,612.32	"P-7-3"	343,612.32	0.00
HARDER, MA. VICTORIA C.	15-Jul-13	435,827.89	"P-7-4"	435,827.89	0.00
HARI, VERONICA GLADY L.	15-Jul-13	610,029.63	"P-7-5"	610,029.63	0.00
HERNANDEZ, CARMELIA AURORA C.	15-Jul-13	176,466.27	"P-7-6"	76,623.12	99,843.15
HERNANDEZ, EDITA M.	15-Jul-13	412,557.52	"P-7-7"	412,557.52	0.00
HERNANDEZ, LOUISE MARGARET M.	15-Jul-13	111,513.48	"P-7-8"	111,513.48	0.00
HERRADURA, JEROME V.	15-Jul-13	490,534.20	"P-7-9"	490,534.20	0.00
HERRERA, VIRGINIA S.	15-Jul-13	241,079.02	"P-7-10"	241,079.02	0.00
HOLGADO, FRANCIA-MACRINA A.	15-Jul-13	518,765.81	"P-7-11"	518,765.81	0.00
HOLGANZA, LUCHI Q.	15-Jul-13	486,306.80	"P-7-12"	486,306.80	0.00
HUELGAS, MARY GRACE P.	15-Jul-13	310,259.77	"P-7-13"	310,259.77	0.00
IGAYA, MARIE STEPHANIE T.	15-Jul-13	166,117.08	"P-7-14"	166,117.08	0.00
IGNACIO, ANA MARIA A.	15-Jul-13	488,523.64	"P-7-15"	488,523.64	0.00
IGNACIO, LETICIA B.	15-Jul-13	503,727.30	"P-7-16"	503,727.30	0.00
INFANTADO, CHRISTINE F.	15-Jul-13	531,243.47	"P-7-17"	531,243.47	0.00
INOCENCIO, JEAN CLAIRE A.	15-Jul-13	208,933.71	"P-7-18"	208,933.71	0.00
JAMON, KRISTINE ANDREA V.	15-Jul-13	142,895.20			142,895.20
JAVIER, CONSUELO D.	15-Jul-13	360,955.71	"P-7-20"	360,955.71	0.00
JAVIER, GIRLIE CLAIRE A.	15-Jul-13	521,011.69	"P-7-21"	521,011.69	0.00
JAVILLONAR, MARJORIE ANN O.	15-Jul-13	178,558.50	"P-7-22"	178,558.50	0.00
JUCABAN, CARLOS DELA COSTA	15-Jul-13	928,742.48	"P-7-23"	928,742.48	0.00
JULIANO, RHEA D.	15-Jul-13	230,973.27	"P-7-19", "P-15"	230,973.27	0.00

JURADO, GLENDA M.	15-Jul-13	147,040.87	"P-7-24"	147,040.87	0.00
KALINGO, CYNTHIA S.	15-Jul-13	354,883.39	"P-7-25"	354,883.39	0.00
LABARRETE, DEBBIE	15-Jul-13	207,929.28	"P-11-1"	207,929.28	0.00
LABOG, VISITACION A.	15-Jul-13	162,464.41	"P-11-2"	162,464.41	0.00
LACASTESANTOS, MA. VICTORIA A.	15-Jul-13	307,540.61	"P-11-3"	307,540.61	0.00
LADABAN, REGINA ANGELA G.	15-Jul-13	271,522.98	"P-11-4"	271,522.98	0.00
LAGDAMEO, LUIS ANTONIO III L.	15-Jul-13	209,852.86	"P-11-5"	209,852.86	0.00
LAGMAN, CRISTINA F.	15-Jul-13	377,250.24	"P-11-6"	377,250.24	0.00
LAPITAN, PAMELA T.	15-Jul-13	244,038.45	"P-10-11"	244,038.45	0.00
LASPIÑAS, NOELLE DIANE B.	15-Jul-13	199,620.44	"P-11-7"	199,620.44	0.00
LAVIDES, MYRNA N.	15-Jul-13	308,117.00	"P-11-22"	308,117.00	0.00
LAVIÑA, EDITHA A.	15-Jul-13	560,127.79	"P-11-8"	560,127.79	0.00
LAYCO, NELIA V.	15-Jul-13	131,633.46	"P-11-9"	131,633.46	0.00
LAZO, MARIA ELOISA C.	15-Jul-13	541,343.50	"P-11-10"	541,343.50	0.00
LEE, KAREN W.	15-Jul-13	299,063.98	"P-5-1"	299,063.98	0.00
LEONILLO, CATHERINE T.	15-Jul-13	338,754.24	"P-11-11"	338,754.24	0.00
LEONO, TERESITA B.	15-Jul-13	192,179.36	"P-11-12"	192,179.36	0.00
LIBOON, MARIE MICHELE S.	15-Jul-13	382,585.11	"P-11-13"	382,585.11	0.00
LIBRADA, NANCY D.	15-Jul-13	133,647.57	"P-11-14"	133,647.57	0.00
LIGERALDE, GERALDINE B.	15-Jul-13	348,674.96	"P-11-23"	348,674.96	0.00
LIGUTOM, MARIE CARR C.	15-Jul-13	278,445.47	"P-11-15"	278,445.47	0.00
LIM, MARIA ROSALYNE	15-Jul-13	268,608.39	"P-11-16"	268,608.39	0.00
LIMQUECO, LEONIDA A.	15-Jul-13	277,125.08	"P-11-17"	277,125.08	0.00
LIWAG, CRISTINA S.	15-Jul-13	208,940.92	"P-11-18"	208,940.92	0.00
LIWANAG, MA. PURIFICACION L.	15-Jul-13	278,363.74	"P-11-19"	278,363.74	0.00
LIWANES, EDYLYN R.	15-Jul-13	296,203.18	"P-11-20"	296,203.18	0.00
LLAMANZARES, LLONA ISABEL	15-Jul-13	173,280.49	"P-11-21"	173,280.49	0.00
LO, CHRISTINE SUSAN L.	15-Jul-13	122,473.16	"P-11-24"	122,473.16	0.00
LO, JACQUELINE L.	15-Jul-13	464,880.00			464,880.00
TOTAL		**Php31,893,754.82**		**Php31,186,136.47**	**Php707,618.35**

In view of the foregoing, only the substantiated amount of Php31,186,136.47 shall be refunded.

WHEREFORE, premises considered, the instant Petition for Review is **PARTIALLY GRANTED**. Respondent Commissioner of Internal Revenue is **ORDERED** to refund in favor of Petitioners the amount of Thirty-One Million One Hundred Eighty-Six Thousand One Hundred Thirty-Six Pesos and 47/100

(Php31,186,136.47), to be individually allocated based on the tabular summary provided earlier, representing their erroneously and illegally collected income tax on compensation income from the Asian Development Bank for taxable year 2012.

SO ORDERED.

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

I CONCUR:

ESPERANZA R. FABON-VICTORINO
Associate Justice

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.

ESPERANZA R. FABON-VICTORINO
Associate Justice
Acting 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.

ROMAN G. DEL ROSARIO
Presiding Justice