REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

QUEZON POWER (PHILIPPINES) LTD., CO.,
Petitioner,

- versus -

C.T.A. CASE NO. 5948

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
MAR 02 2001 Margaret

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DECISION

This is a petition seeking for the refund of the amount of P20,016,399.00 allegedly representing erroneously paid withholding taxes covering the bond interest payments made by Petitioner to a US resident on September 15, 1997 and December 15, 1997.

The antecedent facts follow.

Petitioner is a special purpose limited partnership duly organized and existing under Philippine laws and was formed primarily for the purpose of building, owning and operating a 440 MW (net) baseload pulverized coal-fired electric generation plant, transmission line and certain related facilities to be located in Mauban, Quezon Province ("Mauban Project," for brevity).

To partially finance the construction of the Mauban Project, Petitioner, on July 3, 1997, issued and sold 8.86% Senior Secured Bonds in the principal amount totalling P215,000,000.00, maturing in the year 2017, in a public offering in the United States.

The bonds, represented by two Global bonds, are secured by a first priority lien on and security interest in substantially all of the assets of Petitioner, including its rights under a Power Purchase Agreement and other project contracts (Exh. C). The 8.86% annual interest accruing on the secured bonds is payable quarterly on each March 15, June 15, September 15 and December 15, commencing September 15, 1997.

On September 15, 1997, Petitioner paid interest on the bonds in the amount of P122,904,113.16 to New York Depository Trust Company (NYDTC), a resident of the United States of America and the registered holder of said bonds. Petitioner withheld 15% final income tax on the said interest amounting to P21,688,900.00 pursuant to Article 12(2) of the RP-US Tax Treaty which imposes a maximum tax of 15% on interest derived by a US resident from Philippine sources. The final tax on the interest was computed as follows:

1 year	= 360 days
1 month	= 30 days
Period	= 72 days (July 3, 1997 – Issue Date, to September 15, 1997 – Interest Payment Date)
Interest paid:	$3,809,800.00 (72/360 x 8.86% x $215,000,000)

Withholding Tax:

Grossed up value	$4,482,117.65	($3,809,800 / .85)
Tax	$672,317.65	($4,482,117.65 x 15%)
Peso equivalent	P21,688,900.00	($672,317.65 x P32.2599)

On October 10, 1997, Petitioner filed its Monthly Remittance Return of Income Taxes Withheld (BIR Form No. 1743W) and remitted the final income tax withheld of P21,688,967.29 covering the interest paid on September 15, 1997. (Stipulation of Facts, No. 4, p. 424, CTA Records)

Again, on December 15, 1997, Petitioner paid interest on the bonds in the amount of P183,346,625.26 to NYDTC. Petitioner also withheld 15% final income tax on the said interest in the amount of P32,355,286.00 pursuant to Article 12(2) of the RP-US Tax Treaty, computed as follows:

Period	:	90 days (September 16, 1997 to December 15, 1997)	
Interest Paid	:	$4,762,250	(90/360 x 8.86% x $215,000,000)

Withholding tax:

Grossed up value	$5,602,647.06	($4,762,250 / .85)
Tax	$840,397.06	($5,602,647.06 x 15%)
Peso equivalent	P32,355,286.00	($840,397.06 x P38.5000)

On January 9, 1998, Petitioner filed its Monthly Remittance Return of Income Taxes Withheld (BIR Form No. 1743W) and remitted the final income tax withheld of P32,355,286.00 covering the interest paid on December 15, 1997 (Stipulation of Facts, No. 5, p. 424, CTA Records).

On February 10, 1998, Respondent issued to Petitioner BIR Ruling 18-98, thus:

> "In reply, please be informed that Article 12, paragraphs (1), (3) and (7) of the RP-US Tax Treaty provides, viz:
>
> > "(1) Interest derived by a resident of one of the Contracting State from sources within the other Contracting State may be taxed by both Contracting States.
> >
> > "(2) xxx xxx xxx
> >
> > "(3) Interest by a resident of one of the Contracting State from sources within the other Contracting State with respect to public issues of bonded indebtedness shall not be taxed by other Contracting State at a rate in excess of 10 per cent of the gross amount of such interest.
> >
> > xxx xxx xxx

"(7) The term "interest" as used in the Convention means income from debt claims of every kind, x x x income from government securities and income from bonds or debentures, xxx" (underscoring supplied)

"Based on the foregoing, and since the Notes will be issued and sold to the public through a public offering that will require its registration as securities under the U.S. Securities Act and will be secured by QPLC's rights under the Power Purchase Agreement, other project contracts and substantially all of its fixed assets, the same will qualify as a "public issue of bonded indebtedness." Such being the case, the interest income to be paid to the registered holders of the Notes shall be subject to the preferential tax rate of 10% pursuant to the aforequoted provisions of RP-US Tax Treaty." (Stipulation of Facts, No.2, p.424, CTA Records)

Hence, on the strength of the aforesaid ruling and citing Section 204 (C) of the Tax Code, to state:

"SEC. 204. Authority of the Commissioner to Compromise, Abate and Refund or Credit Taxes. – The Commissioner may –

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"(C) Credit or ***refund taxes erroneously or illegally received*** or penalties imposed without authority, refund the value of internal revenue stamps when they are returned in good condition by the purchaser, and, in his discretion, redeem or change unused stamps that have been rendered unfit for use and refund their value upon proof of destruction. No credit or refund of taxes or penalties shall be allowed unless the taxpayer files in writing with the Commissioner a claim for credit or refund within two (2) years after the payment of the tax or penalty: Provided, however, That a return filed showing an overpayment shall be considered as a written claim for credit or refund. x x x" (Emphasis ours)

Petitioner filed on April 29, 1998 with the BIR an administrative claim for cash refund of the erroneously paid final withholding taxes in the total amount of P20,016,388.22 (Exh. M), computed as follows:

For the September 15 transaction:

Interest paid	$3,809,800

Adjusted Grossed up value	$4,233,111.11	($3,809,800 / .90)	
Adjusted withholding tax	$423,311.11	($4,233,111.11 x 10%)	
Peso equivalent	P13,656,012.54	($423,311.11 x P32.25999084)	
Excess tax			
Amount Actually Remitted		P21,688,961.24	
Amount that Should Have Been Remitted		(P13,656,012.54)	P8,032,948.70

For the December 15 transaction:

Interest paid	$4,762,250		
Adjusted Grossed up value	$5,291,388.89	($4,762,250 / .90)	
Adjusted withholding tax	$529,138.89	($5,291,388.89 x 10%)	
Peso equivalent	P20,371,847.00	($529,138.89 xP38.5000000539)	
Excess tax			
Amount Actually Remitted		P32,355,286.81	
Amount that Should Have Been Remitted		(P20,371,847.29)	P11,983,439.52
Total Excess Final Withholding Tax Paid			**P20,016,388.22**

There being no action on the part of herein Respondent and the two-year prescriptive period was about to lapse the instant petition was filed on October 7, 1999.

Respondent in his Answer filed on November 19 1999, raised the following Special and Affirmative Defenses:

> "4. Petitioner's alleged claim for refund/tax credit is subject to administrative routinary investigation by the Respondent's Bureau;
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> 5. It is incumbent upon Petitioner to show that the total amount of P20,016,399.00 claimed as unutilized excess creditable withholding tax on income payments for calendar year 1996;
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> 6. Taxes are presumed to have been paid and collected in accordance with law;
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> 7. In an action for tax refund, the burden is on the taxpayer to establish its right to refund, and failure to sustain the burden is fatal to the claim for refund;
>
> 8. It is incumbent upon Petitioner to show that it has complied with the provisions of Section 204 in relation to Section 229 of the Tax Code;

9. Well-established is the rule that claims for refund/tax credit are construed in *strictissimi juris* against the taxpayer as they partake the nature of exemption from tax."

The issues, We are tasked to resolve have been stipulated by the parties to be as follows:

"1. Whether the instant Petition was filed within the two-year prescriptive period;

2. Whether Petitioner overpaid the final withholding tax due on the interest paid to US holders of the notes or bonds for taxable year 1997;

3. Whether Petitioner is entitled to the cash refund of its overpaid income tax/excess withholding tax in the total amount of P20,016,399 for taxable year 1997;

4. Whether BIR Ruling No. 18-98 dated February 10, 1998 issued by Respondent to Petitioner is applicable to the facts of this case."

With reference to the first issue, We rule in the affirmative.

Records show that Petitioner's claims for refund in the administrative and judicial level were filed within the two-year period from the date of the payment of the tax as provided for under Section 229 of the Tax Code. The claims for refund were filed with the Bureau of Internal Revenue and this Court on April 29, 1998 and October 7, 1999, respectively, both clearly within two years from October 10, 1997, the date when Petitioner first filed its Monthly Remittance Return of Income Taxes Withheld and paid the 15% final income tax on the September 15, 1997 payment of bond interest.

The three remaining issues shall be tackled jointly as they are interrelated.

As to the applicability of BIR Ruling 18-98, it was no less than the then Commissioner of Internal Revenue who ruled that since the notes will be issued and sold to the public through a public offering that will require its registration as securities under the U.S. Securities Act and will be secured accordingly, the same will qualify as a "public issue of bonded indebtedness"

Therefore, considering that the Notes qualify as a public issue of bonds or bonded indebtedness, and since there exists a tax treaty between the Philippines and the United States, this Court is left with no recourse but to apply the law. Under Article 12, Paragraph 3 of the RP-US Tax Treaty, interest derived by a resident of one of the Contracting States from sources within the other Contracting State with respect to public issues of bonded indebtedness shall not be taxed by the other Contracting State at a rate in excess of 10 per cent of the gross amount of such interest.

Verily, applying BIR Ruling 18-98 and the RP-US Tax Treaty, the interest payment made by the Petitioner should be taxed only at 10%. Since Petitioner withheld 15% final income tax on the said interest, there was an overpayment made to the Bureau of Internal Revenue due to mistake. The same must then be returned to the taxpayer.

Finally, this Court finds the pieces of evidence adduced by Petitioner and which remained uncontroverted by Respondent to be adequate to warrant a refund. Respondent even admitted the existence, genuineness, due execution, validity and the amount of Petitioner's claim for refund in their Joint Stipulation of Facts and Issues (p.425, CTA Records). We reduce, however, the amount to be refunded from P20,016,399.00 to P20,016,388.22 as the latter amount is the original claim sought by Petitioner in the administrative level.

WHEREFORE, in view of all the foregoing, the Court finds the instant petition meritorious and in accordance with law. Accordingly, **RESPONDENT** is hereby

ORDERED to **REFUND** to Petitioner the amount of P20,016,388.22 representing erroneously paid withholding taxes covering the bond interest payments made by the latter to a corporation which is a resident of the United States of America.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

I CONCUR:

AMANCIO Q. SAGA
Associate Judge

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Judge