Republic of the Philippines
Supreme Court
Manila

SUPREME COURT OF THE PHILIPPINES
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FIRST DIVISION

MITSUBISHI CORPORATION – MANILA BRANCH
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

G.R. No. 175772*

Present:

SERENO, *C.J.*, Chairperson,
LEONARDO-DE CASTRO,
DEL CASTILLO,
PERLAS-BERNABE, and
CAGUIOA, *JJ.*

Promulgated:

JUN 05 2017

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DECISION

PERLAS-BERNABE, *J.*:

Assailed in this petition for review on *certiorari*[1] are the Decision[2] dated May 24, 2006 and the Resolution[3] dated December 4, 2006 of the Court of Tax Appeals (CTA) *En Banc* in C.T.A. EB No. 5, reversing the CTA Division's ruling[4] in CTA Case No. 6139 which granted the claim for refund of erroneously paid income tax and branch profit remittance tax (BPRT; collectively, subject taxes) filed by petitioner Mitsubishi Corporation – Manila Branch (petitioner) for the fiscal year that ended on March 31, 1998.

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* Part of the Supreme Court's Case Decongestion Program.

1 *Rollo*, pp. 10-85.

2 Id. at 93-115. Penned by Associate Justice Erlinda P. Uy with Associate Justices Juanito C. Castañeda, Jr., Caesar A. Casanova, and Olga Palanca-Enriquez concurring; Associate Justice Lovell R. Bautista, dissenting (id. at 116-131); and Presiding Justice Ernesto D. Acosta concurring and dissenting.

3 Id. at 132-139.

4 Id. at 152-165. See Decision dated December 17, 2003 penned by Presiding Judge Ernesto D. Acosta with Associate Judge Lovell R. Bautista concurring and Associate Judge Juanito C. Castañeda, Jr. dissenting (id. at 166-172).

The Facts

On June 11, 1987, the governments of Japan and the Philippines executed an Exchange of Notes,[5] whereby the former agreed to extend a loan amounting to Forty Billion Four Hundred Million Japanese Yen (¥40,400,000,000) to the latter through the then Overseas Economic Cooperation Fund (OECF, now Japan Bank for International Cooperation) for the implementation of the Calaca II Coal-Fired Thermal Power Plant Project (Project).[6] In Paragraph 5 (2) of the Exchange of Notes, the Philippine Government, by itself or through its executing agency, undertook to **assume all taxes imposed by the Philippines on Japanese contractors engaged in the Project**:

> (2) The **Government of the Republic of the Philippines will, *itself* or *through its executing agencies*** or instrumentalities, **assume all fiscal levies or taxes** imposed in the Republic of the Philippines *on Japanese firms and nationals operating as suppliers, contractors or consultants* on and/or in connection with *any income* that may accrue from the supply of products of Japan and services of Japanese nationals to be provided under the Loan.[7] (Emphases, underscoring, and italics supplied)

Consequently, the OECF and the Philippine Government entered into Loan Agreement No. PH-P76[8] dated September 25, 1987 for Forty Billion Four Hundred Million Japanese Yen (¥40,400,000,000). Due to the need for additional funding for the Project, they also executed Loan Agreement No. PH-P141[9] dated December 20, 1994 for Five Billion Five Hundred Thirteen Million Japanese Yen (¥5,513,000,000).[10]

Meanwhile, on June 21, 1991, the National Power Corporation (NPC), as the executing government agency, entered into a contract with Mitsubishi Corporation (*i.e.*, petitioner's head office in Japan) for the engineering, supply, construction, installation, testing, and commissioning of a steam generator, auxiliaries, and associated civil works for the Project (Contract).[11] The Contract's foreign currency portion was funded by the OECF loans.[12] In line with the Exchange of Notes, Article VIII (B) (1) of the Contract indicated NPC's undertaking to pay any and all forms of taxes that are directly imposable under the Contract:

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5 Not attached to the *rollo*.
6 *Rollo*, p. 94.
7 Id. at 11 and 117.
8 Id. at 304-313.
9 Id. at 336-344.
10 Id. at 94-95.
11 Id. at 94-95 and 117.
12 Article VI of the Contract provided that the foreign currency portion of the contract price for Phase 1 is funded by the OECF Loan No. PH-P76. Any foreign currency portion of the Contract which is not covered by the first loan shall constitute as Phase II of the Contract. NPC undertook to secure additional funding from OECF for Phase II; hence, Republic of the Philippines entered into the second loan agreement with OECF (id at. 153).

Article VIII (B) (1)

B. FOR ONSHORE PORTION.

> 1.) [The] CORPORATION **(NPC) shall**, subject to the provisions under the Contract [Document] on Taxes, **pay any and all forms of taxes** which are directly imposable under the Contract including VAT, that may be imposed by the Philippine Government, or any of its agencies and political subdivisions.[13] (Emphases supplied)

Petitioner completed the project on December 2, 1995, but it was only accepted by NPC on January 31, 1998 through a Certificate of Completion and Final Acceptance.[14]

On July 15, 1998, petitioner filed its Income Tax Return for the fiscal year that ended on March 31, 1998 with the Bureau of Internal Revenue (BIR). Petitioner included in its income tax due[15] the amount of ₱44,288,712.00, representing income from the OECF-funded portion of the Project.[16] On the same day, petitioner also filed its Monthly Remittance Return of Income Taxes Withheld and remitted ₱8,324,100.00 as BPRT for branch profits remitted to its head office in Japan out of its income for the fiscal year that ended on March 31, 1998.[17]

On June 30, 2000, petitioner filed with the respondent Commissioner on Internal Revenue (CIR) an administrative claim for refund of Fifty Two Million Six Hundred Twelve Thousand, Eight Hundred Twelve Pesos (₱52,612,812.00), representing the erroneously paid amounts of ₱44,288,712.00 as income tax and ₱8,324,100.00 as BPRT corresponding to the OECF-funded portion of the Project.[18] To suspend the running of the two-year period to file a judicial claim for refund, petitioner filed on July 13, 2000 a petition for review[19] before the CTA pursuant to Section 229 of the National Internal Revenue Code (NIRC), which was docketed as C.T.A. Case No. 6139.[20] Petitioner anchored its claim for refund on BIR Ruling No. DA-407-98 dated September 7, 1998,[21] which interpreted paragraph 5 (2) of the Exchange of Notes, to wit:

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13 Id. at 420-421.

14 Id. at 95.

15 The reported total income tax due was ₱90,481,711.00. See id.

16 See id. at 144-145.

17 A ten percent (10%) tax rate was used in accordance with the Philippines-Japan Tax Treaty. Id. at 95.

18 Id. at 157.

19 Dated July 12, 2000. Id. at 142-147.

20 Id. at 157. The CTA Division commissioned Mr. Ruben R. Rubio, a partner of Sycip Gorres Velayo & Co., to examine and verify the voluminous documents supporting petitioner's claim. Mr. Rubio submitted a report revealing erroneously paid income tax and branch profit remittance tax amounting to ₱44,288,712.00 and ₱8,324,100.00. The CTA Division noted that this finding is consistent with petitioner's claims. Id. at 157-158.

21 See id. at 158-160 and 427-428.

> In reply, please be informed that the aforequoted provisions of Notes-NAIA and Notes-Calaca are not grants of direct tax exemption privilege to Japanese firms, Mitsubishi in this case, and Japanese nationals operating as suppliers, contractors or consultants involved in either of the two projects because the said provisions state that it is the Government of the Republic of the Philippines that is obligated to pay whatever fiscal levies or taxes they may be liable to. Thus, there is no tax exemption to speak of because the said taxes shall be assumed by the Philippine Government; hence, the said provision is not violative of the Constitutional prohibition against the grants of tax exemption without the concurrence of the majority of the members of Congress. (Citation omitted)
>
> In view thereof, x x x, this office is of the opinion and hereby holds that **Mitsubishi has no liability for income tax and other taxes and fiscal levies**, including VAT, on the 75% of the NAIA II Project and on the 100% of the foreign currency portion of the Calaca II Project **since the said taxes were assumed by the Philippine Government**.[22] (Emphases and underscoring supplied)

In a Decision[23] dated December 17, 2003, the CTA Division granted the petition and ordered the CIR to refund to petitioner the amounts it erroneously paid as income tax and BPRT.[24] It held that based on the Exchange of Notes, the Philippine Government, through the NPC as its executing agency, bound itself to assume or shoulder petitioner's tax obligations. Therefore, petitioner's payments of income tax and BPRT to the CIR, when such payments should have been made by the NPC, undoubtedly constitute erroneous payments under Section 229 of the NIRC.[25]

The CTA Division acknowledged that based on Revenue Memorandum Circular (RMC) No. 42-99 dated June 2, 1999, amending RMC No. 32-99, the proper remedy for a Japanese contractor who previously paid the taxes directly to the BIR is to recover or obtain a refund from the government executing agency - the NPC in this case. It held, however, that RMC No. 42-99 does not apply to petitioner as it filed its ITR on July 15, 1998 or almost a year before the issuance of the same. It added that RMC No. 42-99 cannot be given retroactive effect as it would be unfair to petitioner.[26]

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22 Id. at 160.
23 Id. at 152-165.
24 The CTA Division held that petitioner substantiated its claim of erroneous payment of income tax and BPRT for the year ended March 31, 1998. Id at. 165.
25 See id. at 161-162.
26 See id. at 163-165.

The CIR moved for reconsideration[27] but was denied in a Resolution[28] dated April 23, 2004; thus, the CIR elevated the matter to the CTA *En Banc*.[29]

The CTA *En Banc*'s Ruling

In a Decision[30] dated May 24, 2006, the CTA *En Banc* reversed the CTA Division's rulings and declared that petitioner is not entitled to a refund of the taxes it paid to the CIR. It held that, *first*, petitioner failed to establish that its tax payments were "erroneous" under the law to justify the refund, adding that the CIR has no power to grant a refund under Section 229 of the NIRC absent any tax exemption. It further observed that by its clear terms, the Exchange of Notes granted no tax exemption to petitioner.[31] *Second,* the Exchange of Notes cannot be read as a treaty validly granting tax exemption considering the lack of Senate concurrence as required under Article VII, Section 21 of the Constitution.[32] *Third,* RMC No. 42-99, which was already in effect when petitioner filed its administrative claim for refund on June 30, 2000, specifies petitioner's proper remedy – that is, to recover the subject taxes from NPC, and not from the CIR.[33]

Petitioner sought reconsideration,[34] but the CTA *En Banc* denied the motion in a Resolution[35] dated December 4, 2006; hence, this petition.

The Issues Before the Court

The issues before the Court are two-fold: (*a*) whether petitioner is entitled to a refund; and (*b*) if in the affirmative, from which government entity should the refund be claimed.

The Court's Ruling

The petition is meritorious.

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27 See motion for reconsideration dated December 30, 2003; id. at 173-180.
28 Not attached to the *rollo*.
29 See petition for review dated May 11, 2004; *rollo*, pp. 181-195.
30 Id. at 93-115.
31 See id. at 99-102.
32 See id. at 102-108.
33 See id. at 109-110.
34 Not attached to the *rollo*.
35 *Rollo*, pp. 132-139.

I.

Sections 204 (C) of the NIRC grants the CIR the authority to credit or refund taxes which are erroneously collected by the government:[36]

> **SEC. 204.** ***Authority of the Commissioner to Compromise, Abate, and Refund or Credit Taxes.*** The Commissioner may —
>
> x x x x
>
> (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 x (Emphases and underscoring supplied)

The authority of the CIR to refund erroneously collected taxes is likewise reflected in Section 229 of the NIRC, which reads:

> **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."
>
> x x x x (Emphases and underscoring supplied)

In this case, it is fairly apparent that the subject taxes in the amount of ₱52,612,812.00 was erroneously collected from petitioner, considering that the obligation to pay the same had already been assumed by the Philippine Government by virtue of its Exchange of Notes with the Japanese Government. Case law explains that an exchange of notes is considered as an **executive agreement**, which is binding on the State even without Senate concurrence. In *Abaya v. Ebdane*:[37]

> An "exchange of notes" is a record of a routine agreement that has many similarities with the private law contract. The agreement consists of the

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[36] See *CBK Power Company Limited, v. CIR*, G.R. Nos. 193383-94 and 193407-08, January 14, 2015, 746 SCRA 93, 108.

[37] 544 Phil. 645 (2007).

> exchange of two documents, each of the parties being in the possession of the one signed by the representative of the other. Under the usual procedure, the accepting State repeats the text of the offering State to record its assent. The signatories of the letters may be government Ministers, diplomats or departmental heads. The technique of exchange of notes is frequently resorted to, either because of its speedy procedure, or, sometimes, to avoid the process of legislative approval.
>
> It is stated that "treaties, agreements, conventions, charters, protocols, declarations, memoranda of understanding, *modus vivendi* and exchange of notes" all refer to "international instruments binding at international law."
>
> x x x x
>
> Significantly, an exchange of notes is considered a form of an executive agreement, which becomes binding through executive action without the need of a vote by the Senate or Congress.[38]

Paragraph 5 (2) of the Exchange of Notes provides for a **tax assumption provision** whereby:

> (2) The **Government of the Republic of the Philippines will, *itself* or *through its executing agencies*** or instrumentalities, **assume all fiscal levies or taxes** imposed in the Republic of the Philippines *on Japanese firms and nationals operating as suppliers, contractors or consultants* on and/or in connection with *any income* that may accrue from the supply of products of Japan and services of Japanese nationals to be provided under the Loan. (Emphases and underscoring supplied)

To "assume" means "[t]o take on, become bound as another is bound, or put oneself in place of another as to an obligation or liability."[39] This means that the obligation or liability remains, although the same is merely passed on to a different person. In this light, the concept of an assumption is therefore different from an exemption, the latter being the "[f]reedom from a duty, liability or other requirement" or "[a] privilege given to a judgment debtor by law, allowing the debtor to retain [a] certain property without liability."[40] Thus, contrary to the CTA *En Banc*'s opinion, the constitutional provisions on tax exemptions would not apply.

As explicitly worded, the Philippine Government, through its executing agencies (*i.e.*, NPC in this case) particularly assumed "all fiscal levies or taxes imposed in the Republic of the Philippines on Japanese firms and nationals operating as suppliers, contractors or consultants on and/or in connection with any income that may accrue from the supply of products of Japan and services of Japanese nationals to be provided under the [OECF] Loan." The Philippine Government's assumption of "all fiscal levies and

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38 Id. at 690-691.

39 Black's law Dictionary, 6th Ed., p. 122. See also *rollo*, p. 161.

40 Black's Law Dictionary, 8th Ed., p. 612.

taxes," which includes the subject taxes, is clearly a form of concession given to Japanese suppliers, contractors or consultants in consideration of the OECF Loan, which proceeds were used for the implementation of the Project. As part of this, NPC entered into the June 21, 1991 Contract with Mitsubishi Corporation (*i.e.*, petitioner's head office in Japan) for the engineering, supply, construction, installation, testing, and commissioning of a steam generator, auxiliaries, and associated civil works for the Project,[41] which foreign currency portion was funded by the OECF loans.[42] Thus, in line with the tax assumption provision under the Exchange of Notes, Article VIII (B) (1) of the Contract states that NPC shall pay any and all forms of taxes that are directly imposable under the Contract:

> Article VIII (B) (1)
>
> B. FOR ONSHORE PORTION.
>
> 1.) [The] CORPORATION **(NPC) shall**, subject to the provisions under the Contract [Document] on Taxes, **pay any and all forms of taxes** which are directly imposable under the Contract including VAT, that may be imposed by the Philippine Government, or any of its agencies and political subdivisions.[43] (Emphases supplied)

This notwithstanding, petitioner included in its income tax due the amount of ₱44,288,712.00, representing income from the OECF-funded portion of the Project, and further remitted ₱8,324,100.00 as BPRT for branch profits remitted to its head office in Japan out of its income for the fiscal year that ended on March 31, 1998.[45] These taxes clearly fall within the ambit of the tax assumption provision under the Exchange of Notes, which was further fleshed out in the Contract. Hence, it is the Philippine Government, through the NPC, which should shoulder the payment of the same.

It bears stressing that the CIR had already acknowledged, through its administrative issuances, that Japanese contractors involved in the Project are not liable for the subject taxes. In RMC No. 42-99, the CIR interpreted the effect of the tax assumption clause in the Exchange of Notes on petitioner's tax liability, to wit:

> The foregoing provisions of the Exchange of Notes mean that the Japanese contractors or nationals engaged in EOCF-funded projects in the Philippines **shall not be required to shoulder all fiscal levies or taxes associated with the project**. x x x
>
> x x x x

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41 *Rollo*, pp. 94-95 and 117.
42 Id. at 153.
43 Id. at 420-421.
45 Id. at 95.

> x x x Since the executing government agencies are mandated to assume the payment of [income taxes] under the Exchange of Notes, the said Japanese firms or nationals **need not pay taxes due thereunder**.[46] (Emphases and underscoring supplied)

The CIR subsequently affirmed petitioner's non-liability for taxes and entitlement to tax refunds by issuing Revenue Memorandum Order (RMO) No. 24-2005[47] addressed to specified BIR offices. The RMO provides:

> Pursuant to the provisions of [RMC] No. 32-99 as amended by RMC No. 42-99, Japanese contractors and nationals engaged in OECF-funded projects in the Philippines **shall not be required to shoulder** the fiscal levies or **taxes associated with the project.** Thus, the concerned Japanese contractors are **entitled to claim for the refund of all taxes paid and shouldered by them** relative to the conduct of the Project.
>
> You are, therefore, directed to expedite/ prioritize the processing of the claims for refund of Japanese contractors and nationals so [as] not to delay and jeopardize the release of the funds for OECF funded projects.[48] (Emphases and underscoring supplied)

Therefore, considering that petitioner paid the subject taxes in the aggregate amount of ₱52,612,812.00, which it was not required to pay, the BIR erroneously collected such amount. Accordingly, petitioner is entitled to its refund.

II.

As above-stated, the NIRC vests upon the CIR, being the head of the BIR, the authority to credit or refund taxes which are erroneously collected by the government. This specific statutory mandate cannot be overridden by averse interpretations made through mere administrative issuances, such as RMC No. 42-99, which – as argued by the CIR – shifts to the executing agencies (particularly, NPC in this case) the power to refund the subject taxes:[49]

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[46] Id .at 164.

[47] Dated October 5, 2005. Id. at 286.

[48] Id.

[49] Id. at 164. The relevant portions of RMC No. 42-99 read thus:

> B) INCOME TAX
>
> 1. Japanese firms or nationals operating as suppliers, contractors or consultants on and/or in connection with any income that accrue from the supply of products and/or services to be provided under the Project Loan, shall file the prescribed income tax returns. Since the executing government agencies are mandated to assume the payment thereof under the Exchange of Notes, the said Japanese firms or nationals need not pay taxes thereunder.
>
> 2. The concerned Revenue District Officer shall, in turn, collect the said income taxes from the concerned executing government agencies.
>
> 3. **In cases where income taxes were previously paid directly by the Japanese contractors or nationals, the corresponding cash refund shall be recovered from the government executing agencies** upon the presentation of proof of payment by the Japanese contractors or nationals." (Emphasis and underscoring supplied)

> 3. **In cases where income taxes were previously paid directly by the Japanese contractors or nationals, the corresponding cash refund shall be recovered from the government executing agencies** upon the presentation of proof of payment by the Japanese contractors or nationals.[50] (Emphasis and underscoring supplied)

A revenue memorandum circular is an administrative ruling issued by the CIR to interpret tax laws. It is widely accepted that an interpretation by the executive officers, whose duty is to enforce the law, is entitled to great respect from the courts. However, such interpretation is not conclusive and will be disregarded if judicially found to be incorrect.[51] Verily, courts will not tolerate administrative issuances that override, instead of remaining consistent and in harmony with, the law they seek to implement,[52] as in this case. Thus, Item B (3) of RMC No. 42-99, an administrative issuance directing petitioner to claim the refund from NPC, cannot prevail over Sections 204 and 229 of the NIRC, which provide that claims for refund of erroneously collected taxes must be filed with the CIR.

All told, petitioner correctly filed its claim for tax refund under Sections 204 and 229 of the NIRC to recover the erroneously paid taxes amounting to ₱44,288,712.00 as income tax and ₱8,324,100.00 as BPRT from the BIR. To reiterate, petitioner's entitlement to the refund is based on the tax assumption provision in the Exchange of Notes. Given that this is a case of tax assumption and not an exemption, the BIR is, therefore, not without recourse; it can properly collect the subject taxes from the NPC[53] as the proper party that assumed petitioner's tax liability.

WHEREFORE, the petition is **GRANTED**. The Decision dated May 24, 2006 and the Resolution dated December 4, 2006 of the Court of Tax Appeals (CTA) *En Banc* in C.T.A. EB No. 5 are hereby **REVERSED** and **SET ASIDE**. The Decision dated December 17, 2003 of the CTA in C.T.A. Case No. 6139 is **REINSTATED**.

SO ORDERED.

ESTELA M. PERLAS-BERNABE
Associate Justice

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50 Id.

51 See *ING Bank N.V. v. CIR*, G.R. No. 167679, April 20, 2016, 790 SCRA 588, 598-599, citing *Philippine Bank of Communications v. CIR*, 361 Phil. 916, 928-929 (1999).

52 *Philippine Bank of Communication v. CIR*, id. at 929.

53 Although the NPC is exempt from the payment of income tax pursuant to Section 13 of its charter (Republic Act No. 6395), the NPC is liable to pay petitioner's tax liabilities to the BIR, in view of the tax assumption provision in the Exchange of Notes and the Contract.

WE CONCUR:

MARIA LOURDES P. A. SERENO
Chief Justice

TERESITA J. LEONARDO-DE CASTRO
Associate Justice

MARIANO C. DEL CASTILLO
Associate Justice

ALFREDO BENJAMIN S. CAGUIOA
Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution, I certify that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

MARIA LOURDES P. A. SERENO
Chief Justice