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FIRST DIVISION

[G.R. Nos. 193383-84, January 14, 2015]

CBK POWER COMPANY LIMITED, PETITIONER, VS. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

[G.R. NOS. 193407-08]

COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS. CBK POWER COMPANY LIMITED, RESPONDENT.

D E C I S I O N

PERLAS-BERNABE, J.:

Assailed in these consolidated petitions for review on *certiorari*[1] are the Decision[2] dated March 29, 2010 and the Resolution[3] dated August 16, 2010 of the Court of Tax Appeals (CTA) *En Banc* in C.T.A. E.B. Nos. 469 and 494, which affirmed the Decision[4] dated August 28, 2008, the Amended Decision[5] dated February 12, 2009, and the Resolution[6] dated May 7, 2009 of the CTA First Division in CTA Case Nos. 6699, 6884, and 7166 granting CBK Power Company Limited (CBK Power) a refund of its excess final withholding tax for the taxable years 2001 to 2003.

The Facts

CBK Power is a limited partnership duly organized and existing under the laws of the Philippines, and primarily engaged in the development and operation of the Caliraya, Botocan, and Kalayaan hydroelectric power generating plants in Laguna (CBK Project). It is registered with the Board of Investments (BOI) as engaged in a preferred pioneer area of investment under the Omnibus Investment Code of 1987.[7]

To finance the CBK Project, CBK Power obtained in August 2000 a syndicated loan from several foreign banks,[8] *i.e.*, BNP Paribas, Dai-ichi Kangyo Bank, Limited, Industrial Bank of Japan, Limited, and Societe General (original lenders), acting through an Inter-Creditor Agent, Dai-ichi Kangyo Bank, a Japanese bank that subsequently merged with the Industrial Bank of Japan, Limited (Industrial Bank of Japan) and the Fuji Bank, Limited (Fuji Bank), with the merged entity being named as Mizuho Corporate Bank (Mizuho Bank). One of the merged banks, Fuji Bank, had a branch in the Philippines, which became a branch of Mizuho Bank as a result of the merger. The Industrial Bank of Japan and Mizuho Bank are residents of Japan for purposes of income taxation, and recognized as such under the relevant provisions of the income tax treaties between the Philippines and Japan.[9]

Certain portions of the loan were subsequently assigned by the original lenders to various other banks, including Fortis Bank (Nederland) N.V. (Fortis-Netherlands) and

Raiffesen Zentral Bank Osterreich AG (Raiffesen Bank). Fortis-Netherlands, in turn, assigned its portion of the loan to Fortis Bank S.A./N.V. (Fortis-Belgium), a resident of Belgium. Fortis-Netherlands and Raiffesen Bank, on the other hand, are residents of Netherlands and Austria, respectively.[10]

In February 2001, CBK Power borrowed money from Industrial Bank of Japan, Fortis-Netherlands, Raiffesen Bank, Fortis-Belgium, and Mizuho Bank for which it remitted interest payments from May 2001 to May 2003.[11] It allegedly withheld final taxes from said payments based on the following rates, and paid the same to the Revenue District Office No. 55 of the Bureau of Internal Revenue (BIR): (a) fifteen percent (15%) for Fortis-Belgium, Fortis-Netherlands, and Raiffesen Bank; and (b) twenty percent (20%) for Industrial Bank of Japan and Mizuho Bank.[12]

However, according to CBK Power, **under the relevant tax treaties** between the Philippines and the respective countries in which each of the banks is a resident, the interest income derived by the aforementioned banks are subject only to a **preferential tax rate of 10%,** *viz*.:[13]

BANK	COUNTRY OF RESIDENCE	PREFERENTIAL RATE UNDER THE RELEVANT TAX TREATY
Fortis Bank S.A./N.V.	Belgium	10% (Article 11[1], RP-Belgium Tax Treaty)
Industrial Bank of Japan	Japan	10% (Article 11[3], RP-Japan Tax Treaty)
Raiffesen Zentral Bank Osterreich AG	Austria	10% (Article 11[3], RP-Austria Tax Treaty)
Mizuho Corporate Bank	Japan	10% (Article 11[3], RP-Japan Tax Treaty)

Accordingly, on April 14, 2003, CBK Power filed a claim for refund of its excess final withholding taxes allegedly erroneously withheld and collected for the years 2001 and 2002 with the BIR Revenue Region No. 9. The claim for refund of excess final withholding taxes in 2003 was subsequently filed on March 4, 2005.[14]

The Commissioner of Internal Revenue's (Commissioner) inaction on said claims prompted CBK Power to file petitions for review before the CTA, *viz*.:[15]

> (1) **CTA Case No. 6699** was filed by CBK Power on June 6, 2003 seeking the refund of excess final withholding tax in the total amount of **P6,393,267.20** covering the year 2001 with respect to interest income derived by [Fortis-Belgium], Industrial Bank of Japan, and [Raiffesen Bank]. An Answer was filed by the Commissioner on July 25, 2003.
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> (2) **CTA Case No. 6884** was filed by CBK Power on March 5, 2004 seeking for the refund of the amount of **P8,136,174.31** covering [the] year 2002 with respect to interest income derived by [Fortis-Belgium], Industrial Bank of Japan, [Mizuho Bank], and [Raiffesen Bank]. The Commissioner filed his Answer on May 7, 2004.

x x x x

(3) **CTA Case No. 7166** was filed by CBK [Power] on March 9, 2005 seeking for the refund of [the amount of] **P1,143,517.21** covering [the] year 2003 with respect to interest income derived by [Fortis-Belgium], and [Raiffesen Bank]. The Commissioner filed his Answer on May 9, 2005. (Emphases supplied)

CTA Case Nos. 6699 and 6884 were consolidated first on June 18, 2004. Subsequently, however, all three cases – CTA Case Nos. 6699, 6884, and 7166 – were consolidated in a Resolution dated August 3, 2005.[16]

The CTA First Division Rulings

In a Decision[17] dated August 28, 2008, the CTA First Division **granted** the petitions and ordered the refund of the amount of **P15,672,958.42** upon a finding that the relevant tax treaties were applicable to the case.[18] It cited DA-ITAD Ruling No. 099-03[19] dated July 16, 2003, issued by the BIR, confirming CBK Power's claim that the interest payments it made to Industrial Bank of Japan and Raiffesen Bank were subject to a final withholding tax rate of **only 10%** of the gross amount of interest, pursuant to Article 11 of the Republic of the Philippines (RP)-Austria and RP-Japan tax treaties. However, in DA-ITAD Ruling No. 126-03[20] dated August 18, 2003, also issued by the BIR, interest payments to Fortis-Belgium were likewise subjected to the same rate pursuant to the Protocol Amending the RP-Belgium Tax Treaty, the provisions of which apply on income derived or which accrued beginning January 1, 2000. With respect to interest payments made to Fortis-Netherlands before it assigned its portion of the loan to Fortis-Belgium, the CTA First Division likewise granted the preferential rate.[21]

The CTA First Division categorically declared in the August 28, 2008 Decision that the required International Tax Affairs Division (ITAD) ruling was not a condition *sine qua non* for the entitlement of the tax relief sought by CBK Power,[22] however, upon motion for reconsideration[23] filed by the Commissioner, the CTA First Division **amended** its earlier decision by reducing the amount of the refund from P15,672,958.42 to **P14,835,720.39** on the ground that CBK Power failed to obtain an ITAD ruling with respect to its transactions with Fortis-Netherlands.[24] In its Amended Decision[25] dated February 12, 2009, the CTA First Division adopted[26] the ruling in the case of *Mirant (Philippines) Operations Corporation (formerly: Southern Energy Asia-Pacific Operations [Phils.], Inc.) v. Commissioner of Internal Revenue (Mirant)*,[27] cited by the Commissioner in his motion for reconsideration, where the Court categorically pronounced in its Resolution dated February 18, 2008 that an ITAD ruling must be obtained prior to availing a preferential tax rate.

CBK Power moved for the reconsideration[28] of the Amended Decision dated February 12, 2009, arguing in the main that the *Mirant* case, which was resolved in a minute resolution, did not establish a legal precedent. The motion was denied, however, in a Resolution[29] dated May 7, 2009 for lack of merit.

Undaunted, CBK Power elevated the matter to the CTA *En Banc* on petition for review,[30] docketed as C.T.A E.B. No. 494. The Commissioner likewise filed his own petition for review,[31] which was docketed as C.T.A. E.B. No. 469. Said petitions were subsequently consolidated.[32]

CBK Power raised the lone issue of whether or not an ITAD ruling is required before it can avail of the preferential tax rate. On the other hand, the Commissioner claimed that CBK Power failed to exhaust administrative remedies when it filed its petitions before the CTA First Division, and that said petitions were not filed within the two-year prescriptive period for initiating judicial claims for refund.[33]

The CTA *En Banc* Ruling

In a Decision[34] dated March 29, 2010, the CTA *En Banc* **affirmed** the ruling of the CTA First Division that a prior application with the ITAD is indeed required by Revenue Memorandum Order (RMO) 1-2000,[35] which administrative issuance has the force and effect of law and is just as binding as a tax treaty. The CTA *En Banc* declared the *Mirant* case as without any binding effect on CBK Power, having been resolved by this Court merely through minute resolutions, and relied instead on the mandatory wording of RMO 1-2000, as follows:[36]

> III. Policies:
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> x x x x
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> 2. Any availment of the tax treaty relief shall be preceded by an application by filing BIR Form No. 0901 (Application for Relief from Double Taxation) with ITAD at least 15 days before the transaction i.e. payment of dividends, royalties, *etc.,* accompanied by supporting documents justifying the relief. x x x.

The CTA *En Banc* further held that CBK Power's petitions for review were filed within the two-year prescriptive period provided under Section 229[37] of the National Internal Revenue Code of 1997[38] (NIRC), and that it was proper for CBK Power to have filed said petitions without awaiting the final resolution of its administrative claims for refund before the BIR; otherwise, it would have completely lost its right to seek judicial recourse if the two-year prescriptive period lapsed with no judicial claim filed.

CBK Power's motion for partial reconsideration and the Commissioner's motion for reconsideration of the foregoing Decision were both **denied** in a Resolution[39] dated August 16, 2010 for lack of merit; hence, the present consolidated petitions.

The Issues Before the Court

In **G.R. Nos. 193383-84**, CBK Power submits the sole legal issue of whether the BIR may add a requirement – prior application for an ITAD ruling – that is not found in the income tax treaties signed by the Philippines before a taxpayer can avail of

preferential tax rates under said treaties.[40]

On the other hand, in **G.R. Nos. 193407-08,** the Commissioner maintains that CBK Power is not entitled to a refund in the amount of P1,143,517.21 for the period covering taxable year 2003 as it allegedly failed to exhaust administrative remedies before seeking judicial redress.[41]

The Court's Ruling

The Court resolves the foregoing *in seriatim.*

A. G.R. Nos. 193383-84

The Philippine Constitution provides for adherence to the general principles of international law as part of the law of the land. The time-honored international principle of *pacta sunt servanda* demands the performance in good faith of treaty obligations on the part of the states that enter into the agreement. In this jurisdiction, treaties have the force and effect of law.[42]

The issue of whether the failure to strictly comply with RMO No. 1-2000 will deprive persons or corporations of the benefit of a tax treaty was squarely addressed in the recent case of *Deutsche Bank AG Manila Branch v. Commissioner of Internal Revenue*[43] (Deutsche Bank), where the Court emphasized that **the obligation to comply with a tax treaty must take precedence over the objective of RMO No. 1-2000**, *viz.*:

> We recognize the clear intention of the BIR in implementing RMO No. 1-2000, but the CTA's outright denial of a tax treaty relief for failure to strictly comply with the prescribed period is not in harmony with the objectives of the contracting state to ensure that the benefits granted under tax treaties are enjoyed by duly entitled persons or corporations.
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> Bearing in mind the rationale of tax treaties, the period of application for the availment of tax treaty relief as required by RMO No. 1-2000 **should not operate to divest entitlement to the relief** as it would constitute a **violation of the duty** required by good faith in complying with a tax treaty. The denial of the availment of tax relief for the failure of a taxpayer to apply within the prescribed period under the administrative issuance would **impair the value** of the tax treaty. At most, the application for a tax treaty relief from the BIR should **merely operate to confirm** the entitlement of the taxpayer to the relief.
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> **The obligation to comply with a tax treaty must take precedence over the objective of RMO No. 1-2000.** Logically, noncompliance with tax treaties has negative implications on international relations, and unduly discourages foreign investors. While the consequences sought to be prevented by RMO No. 1-2000 involve an administrative procedure, these may be remedied through other system management processes, *e.g.*, the imposition of a fine or penalty. **But we cannot totally deprive those who are entitled to the benefit of a treaty for failure to**