

Tax Gems from the Philippines

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On 14 August 2014 the Philippines Court of Tax Appeals (“CTA”) decided case no. 1041 regarding Goodyear. However, the underlying issue was already decided in March 2013 by the same court in case no. 8188. I first discuss both cases before giving my impressions.

Case No. 8188

The facts

First, a summary of the timeline of events, for the sake of clarity:

- 2003-08 – Goodyear Philippines (“GP”) issues shares to Goodyear Tire and Rubber Company (“GT”)
- 2008-08 – Decision to redeem preference shares
- 2008-10-15 – Request to confirm redemption is tax free
- 2008-11-03 – Payment of dividend withholding tax (“DWT”)
- 2008-11-15 – Redemption of shares
- 2010-10-21 – Request DWT refund
- 2010-11-03 – File court appeal for DWT refund

In August 2003 GP issued 13,318,630 5% cumulative preference shares to GT in the US for 1,331,863,000 Philippines Pesos (about USD 24,8 million at the time). GP was in deficit between 2003 and 2009 and did not have free reserves from which to pay the preferred dividends.

In May 2008 GP decided to redeem 3,729,216 of the preference shares per 15

November 2008 for their nominal value plus accrued and unpaid dividends. Those dividends came to 97,732,314 Pesos (about USD 2 million at the time) and are hereafter referred to as “the Income”. On 15 October 2008 GP and GT asked the Philippine Bureau of Internal Revenue (“BIR”) to confirm that the redemption would be tax free under the Philippine/US tax treaty (“the Treaty”, signed at Manila on October 1, 1976, between the Government of the United States of America and the Government of the Republic of the Philippines with respect to taxes on income). Having received no response, GP withheld 15% DWT on the Income and remitted that to the BIR on 3 November 2008. GP claims not to have received any response from the BIR to the request of 15 October 2008 despite various reminders.

Under Philippine law, both a request for a refund of DWT and a court appeal against not receiving that refund must be filed within 2 years after payment of the tax. GP requested a DWT refund from the BIR on 21 October 2010 and filed a complaint with the second division of the Court Tax of Appeals (“CTA”) on 3 November 2010.

Before the CTA, the BIR argued that:

1. GP did not submit the necessary documentation for a refund;
2. GP should allow the BIR to correct subordinate officers decisions first, before resorting to court;
3. the Income is actually a dividend;
4. there was no timely request for treaty relief; and
5. there was no evidence of double tax in the US.

The CTA responded as follows.

Regarding necessary documentation

GP noted that it filed a 172 page request on 21 October 2010 (the letter of 15 October 2008 was 9 pages) and that the BIR only asked for further documentation in a letter dated 10 October 2011. The CTA found GP’s submission sufficient.

Regarding time to allow the BIR an internal review process

The CTA noted that the Philippines Supreme Court made it clear that the 2 year deadline for litigation must be obeyed regardless of the status of an administrative claim. (References to Supreme Court decisions quoted by the CTA can be found in

the CTA decision itself.)

The internal review process rule is also set aside when there is an urgent need for judicial intervention, and when irreparable damage will be suffered. The CTA noted that if GP did not file its CTA appeal 13 days after filing its DWT refund request to the BIR, GP would have suffered irreparable damages as it would have permanently lost its access to court on the refund.

Regarding the income being a dividend

Under article 11'5 of the Treaty source state defines the meaning of "dividends". Philippine law defines the difference between the redemption price of unlisted shares and their cost as a capital gain if the redeeming company is still a going concern; it defines dividends as distributions out of earnings or profits. A redemption is only treated as a dividend if it concerns the redemption of stock first issued as a dividend and subsequently redeemed shortly thereafter.

The CTA concluded that the Income was treated as a dividend under Philippine law, but as a capital gain. It noted that article 14'2 of the Treaty allocates the right to tax gains to the resident state, i.e. the US, unless the gains belong to a permanent establishment or stem from Philippine real estate or real estate companies.

Regarding a timely request for treaty relief

The BIR requires a request for treaty relief to be filed at least 15 days prior to the relevant transaction or payment sheltered by the treaty. GP filed its treaty request 15 October 2008, filed the remittance 19 days later on 3 November and made the redemption payment to GT 31 days later on 15 November. The CTA thus deemed the treaty request to have been filed on time. The Tax Court could also just have declared this point irrelevant and referred to the Philippines' Supreme Court's decision in Deutsche Bank, G.R. No. 188550. August 19, 2013. There, that court determined that national deadlines for withholding tax refunds cannot override a taxpayer's right to a refund (a gem in itself, and all the more so as it was not a decision from a major OECD economy).

Regarding evidence of double taxation

The CTA determined that as the BIR never issued a certificate of final taxes withheld, GT could not claim a tax credit in the US. In addition, GT proved that it

suffered a USD 77 million loss in 2008 and would have had no use for a tax credit.

The second division of the CTA consequently ruled in favour of GP and ordered the BIR to refund the DWT (or issue a tax credit certificate for the DWT).

Case No. 1041

The BIR disputed the second division's decision and petitioned the full bench of the CTA in June 2013 to review case no. 8188. The bench did so and denied the BIR's petition for lack of merit. Whilst largely quoting directly from case no. 8188 for its motivation, the bench added an additional gem.

The BIR argued that it is to decide which documents are needed to justify a refund claim and not the CTA, i.e. if the BIR says the documentation is insufficient, then the taxpayer has no judicial access because the CTA does not have jurisdiction to determine otherwise. The full bench rejected this statement, arguing along with GP that "the prerogative to determine what relevant documents to submit ... belongs to the taxpayer-claimant. Petitioner cannot lay claim to such right for otherwise, a taxpayer-claimant ... will be at her mercy should she require the production of documents that a taxpayer cannot submit." Surely several multinationals could use refer to this in their dealings with foreign tax authorities.

Observations

1. Was this clever tax planning by Goodyear to avoid Philippine DWT? I doubt it, for two reasons: a) it is the exception - not the rule - that businesses (especially large going concerns like GP) will suffer 100 in real losses, just to save 15 in taxes; b) GT was always going to be taxed on Income in the US anyway: if GT had USD 77 million in losses before the redemption and the Income was 2 million, then GT's tax loss carry forward after receiving the Income is reduced to USD 75 million.

2. There are US aspects to this case which were (obviously) not highlighted by the CTA. These include:

- That the US has voluntary joint taxation for US group companies (US IRC 1501). If GT was part of such a group its USD 77 million loss could be absorbed by other group members' profits. This would only move the double tax on the Income forward, as it would lead to earlier cash tax than if GT was taxed by itself.

- That GT could roll the US direct tax credit for the Philippine DWT back for 2 years or forward for 5 (IRC 904(c)) and thus eliminate the double tax the IBR was referring to under their point 5. However, GT might not have gotten the credit if it did not go to the CTA, as the US Inland Revenue Service (“IRS”) might have deemed the unlitigated DWT as a voluntary tax payment, not a compulsory one (IRC 901(b));
- That GT’s currency gain on the value of the preference shares, and its gain on the DWT refund would be subject to US tax as well. The Peso moved 10% from 53.75 Pesos per USD in August 2003 to 49 Pesos per USD November 2008; and 20% from 41 Pesos per USD in March 2013 to 43.75 Pesos per USD in August 2014.

3. I assume that GP waited with its DWT refund request until October 2010, as it was still awaiting the outcome of its request of 15 October 2008. However if it was legally possible to file the request in November 2008 already, that would have taken a lot of pressure out of the case. Still, it is educational to learn that the Philippine deadline for filing a refund request coincides with the deadline for filing a court appeal against the (non-)outcome that refund request. One may be well advised to investigate if this is also the case in other countries where tax refund requests might be disputed by tax authorities.

4. The BIR seems like a difficult authority to deal with.

- They were unresponsive both in the pre-trial procedure and during the trial (see case histories). The BIR blamed a lack of resources. However, this should not be a taxpayer’s problem, especially not an inward investor’s. The problem should also rather be solved through upgrading the BIR’s human resources, or reducing the number of adjustments/disputes it takes on.
- It is abundantly clear from the BIR’s arguments that they believed that it was unfair that taxable dividends could be converted into tax free redemptions. It is also likely that they feared that the remaining $\frac{3}{4}$ of the preference shares would also be redeemed, leading to a DWT saving three times as big as the one they were fighting.
However, if the government does not like the law, then the government should change the law, not twist the plain meaning of the literal texts to reach their desired outcome. This must hurt inward investment, which is a pity.

5. The Philippine court system presents much better news. It seems like it could be another rich source of international corporate tax treasures in English. The CTA decisions for November 2014 include household names such as Maersk, Nokia, Shell, Chevron, 3M and Sony Ericsson. The decisions of the CTA can be found at <http://cta.judiciary.gov.ph/> and the Supreme Court at <http://sc.judiciary.gov.ph/>. In particular, the CTA's dealing with question of who determines what documentation to submit or a DWT refund request seems extremely valuable and practical and makes these courts seem as trustworthy as any other and worth following.