

Headline	Tax treatment of compensation income of ADB Filipino employees		
MediaTitle	The Philippine Star		
Date	12 Sep 2017	Language	English
Section	Business	Journalist	John R. Pascual
Page No	B4	Frequency	Daily



Tax treatment of compensation income of ADB Filipino employees

It is a well settled principle that “taxation is the rule, tax exemption is the exception.” Tax exemptions must be strictly interpreted such that exemption will not be conferred unless the terms under which it is granted clearly and distinctly show that such taxpayer is exempted from his share in the common burden of taxation.

In other words, tax exemptions are never presumed and are strictly interpreted against the taxpayer and liberally in favor of the taxing authority. This norm was reiterated by the Court of Tax Appeals in the case of *Rowena Vicente et al. vs. Commissioner of Internal Revenue*, where several ADB Filipino employees

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filed various claims for refund of supposed erroneous payment of income taxes on compensation income for taxable years 2012 and 2013.

For several decades, ADB Filipino employees did not pay their income taxes. The basis for non-payment of income tax were the provisions of ADB Charter and ADB Headquarters Agreement. Chapter VIII, Article 56 (2) of the ADB Charter provides that “no

tax shall be imposed on the salaries and emoluments paid by the bank to the directors, alternates, officers or employees of the bank, including expert performing missions for the bank, except where a member deposits with its instrument of ratification or acceptance a declaration that such member retain for itself and its political subdivisions the right to tax salaries and emoluments paid by the bank to citizens or nationals of such member.” Further, Section 45 (b) of the ADB Headquarters Agreement provides that ADB officers and staff shall enjoy exemption from taxation on the salaries or compensation paid by ADB subject to the power of the government to tax its nationals. However, such non-payment of income tax ceased when the BIR issued Revenue Memorandum Circular (RMC) No. 31-2013. In summary, Section 2(d) (1) of said RMC provides that only non-Filipino officers and staff of the ADB shall be exempt from Philippine income tax. Since RMC No. 13-2013 was given retroactive effect, the ADB Filipino employees were ordered to declare their income for taxable year 2012 onwards that prompted said employees to question the legality of Section 2(d) (1) of said RMC.

After the RTC declared Section 2(d) (1) of RMC No. 13-2013 null and void, several ADB Filipino employees filed their claim for refund of income tax payments for taxable years 2012 and 2013 which they claimed to be illegally collected by the government. The BIR argued that said employees are not entitled to refund since being Philippine citizens, they are liable for income tax as enunciated under Section 22 (E) and Section 23 of the Tax Code. Further, the BIR argued that ADB Headquarters

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Agreement made it clear that such exemption was subject to the power of the Philippine government to tax its nationals.

In deciding the issue regarding the claim for refund, the CTA ruled that ADB Filipino employees are not exempted from income tax. The CTA explained that the ADB Charter, as well as the ratification of then president Ferdinand Marcos, were clear in giving the government the right to impose tax on the salaries or compensation of ADB Filipino employees. With the ratification, the CTA further held that it overruled any semblance of tax exemption accorded by the ADB Charter and ADB Headquarter Agreement to its Filipino employees. Despite declaring RMC No. 13-2013 to be in accord with the provision of the ADB Charter, the CTA still decided to partially grant the claim for refund of the ADB Filipino employees. Based on the principles of fair play and substantial justice, the CTA said that provisions of RMC No. 13-2013 should be applied prospectively as Section 246 of the Tax Code provides that no issuance of the commissioner of internal revenue shall be given retroactive application if the revocation, modification or reversal will be prejudicial to the taxpayer. As enunciated by the Supreme Court in the case of *Commissioner of Internal Revenue vs. Court of Appeals, Court of Tax Appeals and Alhambra Industries Inc.*, the court held that "Well entrenched is the rule that rulings and circulars, rules and regulations promulgated by the CIR would have no retroactive application if to so apply them would be prejudicial to the taxpayers." In other words, the ADB Filipino employees should not be faulted from claiming such exemption since several past revenue officials held that their salaries were exempted from income tax. Hence, the CTA ordered the BIR to issue a tax refund or tax credit certificate in favor of the ADB Filipino employees representing the illegally collected income taxes for taxable year 2012.

In light of the CTA decision, all is not lost for ADB Filipino employees as this may still be elevated to the Supreme Court. As pronounced by the court in the case of *Nippon Express (Philippines) Corp. vs. Commission of Internal Revenue*, it held that "Only decisions of this court constitute binding precedents, forming part of the Philippine legal system." Thus, being the final arbiter of judicial controversy, the Supreme Court may affirm, reverse or modify this decision as the facts and law may warrant.

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