

Title: National Development Company v. Commissioner of Internal Revenue

Facts:

1. The National Development Company (NDC) entered into contracts in Tokyo with Japanese shipbuilding companies for the construction of twelve ocean-going vessels.
2. The purchase price was financed by bonds issued by the Central Bank.
3. Initial payments were made through cash and irrevocable letters of credit; the balance was covered by fourteen promissory notes signed by NDC and guaranteed by the Republic of the Philippines.
4. NDC remitted to the shipbuilders in Tokyo a total of US\$4,066,580.70 as interest on the purchase price balance without withholding any tax.
5. The Commissioner of Internal Revenue held NDC liable for the tax on the interest, amounting to P5,115,234.74.
6. Negotiations between NDC and the Bureau of Internal Revenue (BIR) to resolve the outstanding tax liability failed, leading to the issuance of a warrant of distraint and levy against NDC by the BIR.
7. NDC appealed to the Court of Tax Appeals (CTA), which sustained the BIR's decision but reduced the tax deficiency by P900.00.
8. NDC filed a petition for certiorari with the Supreme Court to contest the CTA's decision.

Issues:

1. Whether the interest payments on the promissory notes issued by the NDC to the Japanese shipbuilders were subject to Philippine income tax.
2. Whether the interest was considered derived from sources within the Philippines.
3. Whether the guarantee by the Republic of the Philippines on the promissory notes exempted the interest from taxation.
4. Whether the failure of NDC to withhold taxes made it personally liable for the unpaid tax amounts.

Court's Decision:

1. ****Taxability of Interest Payments****: The Supreme Court ruled that the interest payments made to the Japanese shipbuilders were subject to Philippine income tax under Section 37 of the Tax Code because the source of the interest was a resident domestic corporation (NDC). The law specifies that interest payments by residents of the Philippines are considered income from sources within the Philippines.
2. ****Source of Income****: The court clarified that the "source" of interest income is the

obligor who pays the interest, i.e., the NDC, a domestic corporation with principal offices in Manila. Thus, the interest payments to the Japanese shipbuilders were sourced within the Philippines and subject to tax.

3. **Exemption Claim**: The court found no basis for NDC's claim that the interest payments were exempt as government securities under Section 29(b)(4) of the Tax Code. The relevant authorizing law did not provide an exemption from taxation.

4. **Liability for Failure to Withhold**: The court held NDC liable under Section 53(c) of the Tax Code for failing to withhold the required taxes from the interest payments made to the Japanese shipbuilders. The liability was considered a penalty for this omission.

Doctrine:

1. **Source of Interest Income**: The source of interest income is the residence of the obligor who pays the interest, not the physical location of the securities or the place of payment.

2. **Taxation of Interest Payments**: Interest paid by a domestic corporation to a foreign entity is considered income derived from sources within the Philippines and is subject to Philippine income tax unless an explicit exemption is provided by law.

3. **Liability for Non-Withholding**: A withholding agent who fails to withhold the correct tax is personally liable for the amount not withheld, and this liability cannot be waived through general statutory provisions favoring exemptions.

Class Notes:

- **Source of Income**: Under Section 37 of the Tax Code, the source of interest income is determined by the residence of the obligor.

- **Withholding Tax**: Section 53(c) places a duty on withholding agents to withhold tax from payments to foreign entities and holds them personally liable for failures to withhold.

- **Exemption Clauses**: Exemptions from income tax must be explicitly stated in the law; there can be no implied exemptions.

Historical Background:

- **Context**: The case occurred against the backdrop of post-war economic recovery and industrialization efforts in the Philippines. National Development Company's contracts for shipbuilding played a role in strengthening the nation's maritime infrastructure, which necessitated the financing of significant loans and promissory notes.

The decision reflects the Philippine government's resolve in ensuring the collection of proper taxes, even from international transactions, and emphasizes the strict adherence to tax laws and the responsibilities of withholding agents.