REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

CALIFORNIA MANUFACTURING COMPANY, INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 5186

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
JUN 27 1997

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DECISION

Case at bar refers to a claim for refund in the amount of ₱14,095,336.50 as alleged overpaid withholding tax on royalty payments to CPC International (Asia) Ltd., Delaware, U.S.A. (CPC Asia, for brevity) corresponding to the period January, 1992 to September, 1993.

Petitioner, California Manufacturing Company, Inc. (CMC, for short) is a registered domestic corporation with principal office address at KM 18 South Superhighway, Parañaque, Metro Manila.

On June 1, 1987, CPC Asia entered into a Trademark Licensing Agreement with CMC, whereby for a period of five (5) years the former would allow the latter to use exclusively certain trademarks in the Philippines. In return, the latter would pay royalties of 1% based on the net sales value of the products sold under the said trademarks. The Trademark Licensing Agreement was registered with the Bureau of Patents, Trademarks and Technology Transfer (BPTTT) on July 12, 1989, valid from

1 June 1987 to 31 May 1992 as evidenced by Certificate of Registration No. 941 (Annex "J" to Petition for Review; p. 39, CTA records).

On the same date (June 1, 1987), the aforesaid parties also entered into a Technology Licensing Agreement. Under such agreement, for a period of five (5) years, CPC Asia, as a service company for CPC U.S.A. and Ajinomoto Co., Inc. (AJICO, for short), would provide CMC technologies of CPC U.S.A. and AJICO, to be used in the manufacture and distribution of certain products in the Philippines. Again, in return, petitioner CMC agreed to pay a 2% royalty on the net sales of all products it manufactured and sold. This Technology Licensing Agreement was also registered with the BPTTT as evidenced by Certificate of Registration No. 942, dated July 12, 1989, valid from 1 June 1987 to 31 May 1992 (Annex "M" to Pet. for Review; p. 82, CTA rec.).

The two agreements mentioned above were renewed for another period of five (5) years from 1 June 1992 to 31 May 1997, as shown by Certificates of Registration Nos. 1369 (Exh. "A", Pet.; pp. 202-204, CTA rec.) and 1370 (Exh. "B", Pet.; pp. 225-227, CTA rec.).

For the tax year 1992 and the period January to September 1993, petitioner remitted royalties to CPC Asia in the amount of ₱93,968,907.00. It withheld taxes thereon in the amount of ₱23,492,227.50, equivalent to 25% of the royalties remitted in compliance with Revenue Memorandum Circular (RMC) No. 39-92, issued on July 1, 1992.

Petitioner believes that under Article 13.2(b)(iii) of the RP-US Tax Treaty in relation to Article 12(2)(b) of the RP-West Germany Tax Treaty, the royalties remitted to CPC Asia are subject only to 10% withholding tax.

Hence, on November 18, 1993, petitioner filed with the BIR a claim for refund of the overpaid withholding tax for the subject period in the amount of ₱14,095,336.50, computed as follows:

Period Covered	Gross Royalties	Royalty Tax Paid (25%)	Should Be Tax (10%)	Amount for Refund
Jan.-Mar. '92	₱11,011,754.00	₱ 2,752,938.00	₱1,101,175.00	₱ 1,651,763.00
Apr.-June '92	12,678,851.00	3,169,713.00	1,267,885.00	1,901,828.00
July-Sept. '92	12,599,608.00	3,149,902.00	1,259,961.00	1,889,941.00
Oct.-Dec. '92	19,780,438.00	4,945,110.00	1,978,044.00	2,967,066.00
Jan.-Mar. '93	11,704,982.00	2,926,245.50	1,170,498.00	1,755,747.50
Apr.-June '93	13,018,258.00	3,254,565.00	1,301,826.00	1,952,739.00
July-Sept. '93	13,175,016.00	3,293,754.00	1,317,502.00	1,976,252.00
	₱93,968,907.00	₱23,492,227.50	₱9,396,891.00	₱14,095,336.50

In her Answer, filed through registered mail on April 18, 1995, respondent alleged the usual special and affirmative defenses, summarized as follows:

1. The claim of petitioner is pending administrative investigation;

2. The claim was not in the proper BIR Form (TC-001 or TC-002).

3. Rulings allowing the availment of the benefits under the "most favored nation" clause on payments of royalties to recipients in the United States have been revoked effective January 21, 1992; hence, royalty payments are subject to 25% withholding tax rate;

4. A resident of the United States is not entitled to the "most favored nation" tax rate of 10% on royalty income derived from the Philippines as payment of such tax is not under similar circumstances, considering that in Germany there is a matching credit of 20% for royalties, while in the United States there is no such similar credit granted;

5. Claims for refund are strictly construed against the taxpayer;

6. Exemption from tax must be under clear and unmistakable terms found in the statute;

7. In a tax refund case, the taxpayer has the burden of proof to show that it is entitled to the refund; and

8. The petition does not state a cause of action.

The sole issue in this case is whether or not petitioner is entitled to the refund of ₱14,095,336.50 representing alleged overpayment of withholding tax on royalties.

The Court rules in favor of petitioner. Respondent's arguments in her special and affirmative defenses had long been settled by this Court in the case of **IBM Philippines, Inc. v. Commissioner of Internal Revenue, CTA Case No. 4308, promulgated on March 31, 1993,** where it was ruled that:

> "On the second issue, whether or not petitioner should be taxed at the reduced rate of 10% withholding tax on royalties in accordance with Article 12(2)(b) of the R.P. - West Germany Tax Treaty and not 25% withholding tax on royalties under Article 13(2)(b)(iii) of the R.P. - U.S. Tax Treaty.
>
> This Court is of the persuasion that petitioner's stand is correct and concurs with the opinion rendered by then Commissioner of Internal Revenue, Bienvenido Tan, Jr., (BIR Ruling No. 456-88, supra), that under the most favored nation provision of the R.P. - U.S. Tax Treaty (Article 13 paragraph 2(b)(iii), the tax imposable on royalties derived by a resident of the United States from sources within the Philippines shall be the lowest rate of Philippine tax that may be imposed on royalties of the same kind paid under similar circumstances to a resident of a third state. Article 12, paragraph 2(b) of the R.P. - West Germany Tax Treaty, provides that royalties arising in the Philippines and paid to a resident of West Germany may also be taxed in the Philippines, but the tax so charged shall not exceed 10% of the gross amount of royalties. Said treaty also provides that for as long as the transfer of technology under Philippine law, is subject to approval, the limitation of the tax rate in case of royalties arising in the Philippines, apply if the contract giving rise to such royalties has been approved by Philippine competent authorities.
>
> Thus, inasmuch as the Agreement between World Trade and IBM Phils. as well as the Agreement between IBM and IBM Phils. had been approved by the Central Bank of the Philippines, royalties arising in the Philippines and payable to World Trade as well as to IBM by IBM Phils. should be taxed at the rate of 10% because said rate is indicated in the R.P. - West Germany Tax Treaty and pursuant to Article 13, paragraph 2(b)(iii), of the R.P. - US Tax Treaty."

Respondent's allegation that the provision of matching credit under Article 24 of the RP - West Germany Tax Treaty negates the application of the "most favored nation" clause of the RP - US Tax Treaty, because the payment of tax on royalties is not "under similar circumstances", had likewise been resolved by this Court in a Resolution, dated July 21, 1993, and promulgated under aforementioned CTA Case No. 4308. In said Resolution, this Court resolved that:

> It is claimed by the respondent that this Court erred in granting the refund since "petitioner is not entitled to the `most favored tax' rate on royalties." (Motion, C.T.A. Records, p. 345)
>
> The applicable provision of the R.P. - U.S. Tax Treaty provides:
>
> > "Art. 13 (2)(b)(iii). xxx (T)he tax imposed by that other Contracting State shall not exceed the lowest rate of Philippine tax that may be imposed on royalties of the same kind paid under similar circumstances to a resident of a third state." (Underscoring supplied)
>
> Respondent advanced his argument on the premise that the R.P. - Germany Tax Treaty, which provides for a 10% tax on royalties, does not apply in the case under consideration. He argued that:
>
> > "Under the xxx provisions of the German Tax Treaty, there is a `matching credit' in Germany of 15% and 20%. A perusal of Article 23 (Relief from Double Taxation of the R.P. - U.S. Tax Treaty), there is no such tax credit so that the IBM WORLD TRADE CORPORATION AND INTERNATIONAL BUSINESS MACHINES CORPORATION are not entitled to the `most favored nation' tax rate on royalties (10%) because their payment of the tax is not under similar circumstances i.e., there is `matching credit' in Germany (20% for royalties), while there is no such credit in the U.S. xxx." (Motion, C.T.A. Records, p. 348)
>
> Quoted below is the pertinent provisions of the R.P. - Germany Tax Treaty which reads:
>
> > "Article 24
> >
> > Relief from Double Taxation
> >
> > 1. Tax shall be determined in the case of a resident of the Federal Republic of Germany as follows:
> >
> > xxx xxx xxx
> >
> > b) Subject to the provisions of German tax law regarding credit for foreign tax, there shall

> be allowed as a credit against Germany income and corporation tax payable in respect of the following items of income arising in the Republic of the Philippines, the tax paid under the laws of the Philippines and in accordance with this Agreement on:
>
> xxx xxx xxx
>
> dd) royalties, as defined in paragraph 3 Article 12;
>
> xxx xxx xxx
>
> c) For the purpose of credit referred to in subparagraph (b), the Philippine tax shall be deemed to be
>
> xxx xxx xxx
>
> cc) in the case of royalties for which the tax is reduced to 10 or 15 percent according to paragraph 2 of Article 12, 20 percent of the gross amount of such royalties."

To settle once and for all the legal issue involved in this case, this Court deems it wise to decide on the proper interpretation of the phrase "paid under similar circumstances". Does the phrase refer to tax paid as claimed by respondent or does it refer to royalties paid as advanced by petitioner?

A cursory perusal of the provision makes this Court to agree with the petitioner's interpretation. The phrase "paid under similar circumstances" is followed by the phrase "to a resident of a third state." It is clear that what is paid to a resident of a third state is royalty and not tax.

Petitioner succinctly put in its "Opposition to Motion for Reconsideration" that:

> "Respondent is in effect amending the provision of the R.P. - U.S. tax treaty. Article 13(2)(b)(iii) speaks of \`royalties of the same kind paid under similar circumstances to a resident of third state'. Nowhere does it speak, whether express or implied, of tax paid under similar circumstances. Respondent is reading into the R.P. - U.S. tax treaty something that is clearly not there.
>
> The requirement of \`similar circumstances' is in relation to the payment of royalty, not payment of the tax. Thus, for instance, the royalty in question paid to a U.S. resident by petitioner (which is neither BOI-registered enterprise nor engaged in a preferred-pioneer activity) is not paid under similar circumstances as a royalty paid to an

> Austrian resident by a Philippine company that is BOI-registered and engaged in a preferred-pioneer activity. Also, a royalty paid to a resident of Denmark or Sweden in respect of motion picture films and tapes is not paid under similar circumstances as the royalty herein paid by petitioner to its U.S. licensors. Clearly, the phrase `similar circumstances' is used in reference to the payment of the royalty, and not in reference to the payment of tax." (Opposition, C.T.A. Records, pp. 363-364).

This Court has emphasized the two important requirements that should be present/or complied with before the 10% rate of withholding tax on royalties remitted to a U.S. resident may be availed of. These are:

1. It is necessary that there be an agreement or a contract whereby the royalties paid to the U.S. must originate from the use of, or the right to use any patent, trademark, design or model, plan, secret formula or process, or from the use, or the right to use, industrial, commercial or scientific experience; and

2. The contract or agreement must be duly approved by Philippine competent authorities. **(Jardine Davies, Inc. and Macwhyte Company, a Division of Amsted Industries, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 5141, April 23, 1996, p. 13)**

Petitioner has complied with the above-mentioned requirements. It offered in evidence Certificate of Registration No. 1369 together with the Renewal Agreement of its Trademark Licensing Agreement (Exhs. "A" to "A-4", inclusive; pp. 202-224-a, CTA rec.). It also offered in evidence Certificate of Registration No. 1370 together with the Renewal of its Technology Licensing Agreement (Exhs. "B" to "B-4", inclusive; pp. 225-257, CTA rec.). Both certificates were duly issued by the Technology Transfer Registry of the BPTTT.

Likewise, petitioner presented the Monthly Remittance Returns of Income Taxes Withheld (BIR Form 1743 W) for the different quarters of the subject period to prove that the amount being claimed as refundable or tax creditable was actually remitted to the BIR. Such returns as well as the computations of royalty payments and the corresponding withholding taxes due thereon were also offered in evidence by petitioner.

Respondent, on her part, did not present controverting evidence. On the contrary, her evidence even supported or favored the granting of the refund. Thus, the Memorandum Report, dated September 15, 1994, of respondent's revenue officer, clearly stated that:

> "In view of the foregoing, it is respectfully recommended that the request for tax refund in the amount of ₱14,095,336.50 by the above taxpayer be granted." (Exh. "2", pp. 327-328, CTA rec.)

However, although it was recommended that the whole amount of ₱14,095,336.50 be refunded, still this Court is of the opinion and so holds that the amount being claimed for refund should be reduced by reason of prescription pursuant to Section 230 of the Tax Code, as amended. The period beginning January 1992 up to September 1992 has prescribed since the petition for review was filed on December 28, 1994. Thus, withholding tax payments made prior to December 28, 1992 have prescribed. Therefore, petitioner is only entitled to the refund of the sum of ₱8,651,804.50, computed as follows:

Period Covered	Gross Royalties	Royalty Tax Paid (25%)	Date Paid	Should Be Tax (10%)	Amount Refundable
Oct.-Dec. '92	₱19,780,438.00	₱ 4,945,110.00	1-08-93	₱1,978,044.00	₱2,967,066.00
Jan.-Mar. '93	11,704,982.00	2,926,245.50	4-12-93	1,170,498.00	1,755,747.50
Apr.-June '93	13,018,258.00	3,254,565.00	7-12-93	1,301,826.00	1,952,739.00
July-Sept. '93	13,175,016.00	3,293,754.00	10-11-93	1,317,502.00	1,976,252.00
		₱14,419,674.50		₱5,767,870.00	₱8,651,804.50

WHEREFORE, finding the instant petition partially meritorious, the Court hereby **GRANTS** petitioner's claim for refund in the amount of ₱8,651,804.50, representing overpaid withholding tax on royalties from the period October 1992 to September 1993. Respondent is hereby **ORDERED** to **REFUND** in favor of petitioner the amount of EIGHT MILLION SIX HUNDRED FIFTYONE THOUSAND EIGHT HUNDRED FOUR PESOS AND FIFTY CENTAVOS (₱8,651,804.50).

No pronouncement as to costs of suit.

SO ORDERED.

RAMON O. DE VEYRA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

AMANCIO Q. SAGA
Associate Judge

CERTIFICATION

I hereby certify that this decision was reached after due consultation with the members of this Court in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals