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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PURINA PHILIPPINES, INC.
Petitioner,

- versus -

C.T.A. CASE NO. 5286

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
OCT 17 1997

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DECISION

This petition is seeking for the refund or issuance of tax credit certificate in the amount of P2,108,137.30 alleged to be overpaid withholding taxes on royalties made by the petitioner covering the period January 1, 1992 to September 30, 1993.

Petitioner, a domestic corporation, duly organized and existing under Philippine laws, entered into a TRADEMARK LICENSE AGREEMENT (Exh. "A") dated May 1, 1991, with RALSTON PURINA COMPANY (RPC), a corporation organized and existing under the laws of the State of Missouri, U.S.A., for the use of Ralston trademarks. Under this Trademark License Agreement, petitioner agreed to pay and remit to RPC a monthly fee or royalty equivalent to one percent (1%) of net sales of licensed products in the Philippines.

Also on May 1, 1991, petitioner entered into a TECHNICAL ASSISTANCE AGREEMENT (Exh. "B") with RALSTON INTERNATIONAL SERVICE COMPANY (RISCO), a corporation organized and existing under the laws of the State of

Missouri, U.S.A., for the right to use the proprietary technical information and knowledge of RISCO in order to develop, manufacture and use their products in the Philippines. The Technical Assistance Agreement shall be effective for five (5) years from the date on which Purina commences commercial production of the licensed products in the Philippines. For the use of the said technical information, petitioner agreed to pay and remit to RISCO a monthly fee or royalty equivalent to two percent (2%) of net sales of licensed products in the Philippines.

The Trademark License Agreement and the Technical Assistance Agreement between petitioner and the licensors were all duly registered and approved by the Bureau of Patents, Trademark and Technology Transfer (BPTTT) as evidenced by Certificate of Registration No. 1240, dated August 1, 1991 (Exh. "C") and Certificate of Registration No. 1268, dated October 22, 1991 (Exh. "D") respectively. Both Agreements shall be effective for five (5) years from September 1, 1991 to August 31, 1996.

On July 1, 1992, respondent issued Revenue Memorandum Circular No. 39-92 revoking existing rulings and holding that"

> "Accordingly, a resident of a third State is <u>not</u> entitled to the "most favored nation's tax rate of 10% on royalty income derived from the Philippines because the payment of such tax is not under similar circumstances since there is a matching credit in Germany (20% for royalties), while there is no such similar credit granted by the United States."

In compliance with the respondent's Revenue Memorandum Circular No. 39-92, petitioner on September 10, 1993, filed with the BIR its Monthly Remittance Return of Income Taxes Withheld and paid the amount of

P3,254,197.24 representing 25% withholding tax including surcharge and interests for late payment, on royalty payment to both RPC and RISCO for the period January 1, 1992 to August 31, 1993 in the total amount of P9,805,141.96.

Likewise, on October 11, 1993, petitioner filed its Monthly Remittance Return of Income Taxes Withheld for the month of September 1993 reflecting the amount of P1,027,604.00 as royalties paid to RPC and RISCO and correspondingly paid the 25% withholding tax thereon amounting to P256,901.00.

Subsequently, however, on March 31, 1993, this Court settled the same issue in the case of **IBM Philippines vs. Commissioner of Internal Revenue, CTA Case No. 4308**, where it ruled that 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, and since under the RP-West Germany Tax Treaty, the tax so charged shall not exceed 10% of the gross amount of the royalties, being the lowest rate imposable, the same rate should be applied on royalties derived by a resident of the United States.

The petitioner, therefore, filed a written claim for refund (Exh. "S") dated August 22, 1994 with respondent's office on the excess 15% royalty tax payments amounting to P2,108,137.30, computed as follows:

Period Covered	Royalty Payable	Withholding Tax at 25%	Withholding Tax at 10%	Excess Tax Payments
Jan. 01, 1992 to August 31, 1993	P 9,805,141.96	P3,254,197.24	P1,300,200.54	P1.953,996.70
Sept. 1993	1,027,605.00	256,901.00	102,760. 40	154,140.60
Total	P10,832,746.96	P3,511,098.24	P1,402,960.94	P2,108,137.30

Considering that the two-year period mandated by law under Sections 204 and 230 of the Tax Code is about to expire, inaction of the respondent on the claim for refund in the amount of P2,108,137.30 prompted the petitioner to file the instant petition on September 8, 1995.

Respondent, as a defense, professed that the decision of this Court in the IBM Case (supra) did not expressly revoke nor declare Revenue Memorandum Circular No. 39-92 as null and void and of no effect, hence, it still stands valid and enforceable. She also maintained in her Answer, that the said Memorandum Circular was issued pursuant to the power of the Commissioner of Internal Revenue to make rulings or opinions in connection with the implementation of the provisions of the internal revenue laws statutorily recognized under Section 245 of the Tax Code and as such, commands respect and weight. Furthermore respondent asserted the familiar defenses, that the petitioner, who has the burden of proving that it is entitled to the tax refund, failed to establish that the taxes paid were erroneously or illegally collected and that tax refunds, being in the nature of an exemption, are construed strictly against the taxpayer.

We are tasked to resolve the following issues:

1. Whether or not the 10% withholding tax provided in Article 12, 2(b) of the R.P.-West Germany Tax Treaty is applicable to licensing agreements covered by the R.P.-U.S.Tax Treaty.

2. Whether or not petitioner is entitled to a tax refund or tax credit in the amount of P2,108,137.30 representing overpaid or erroneously paid withholding tax on royalties for the period January 1, 1992 to September 1993.

We rule affirmatively in favor of the petitioner in the light of our previous decisions in similar cases involving identical issues where We concurred with the ruling pronounced by the then Commissioner of Internal Revenue, Bienvenido Tan (BIR Ruling No. 456-88), that a 10% tax rate shall be imposed on royalties derived by a resident of the United States from sources within the Philippines pursuant to the most favored nation provision of the RP-US Tax Treaty (Article 12(b)(iii) in relation to Article 12(2)(b) of the RP-West Germany Tax *Treaty (Abbot Laboratories, (Philippines) vs. Commissioner of Internal Revenue, CTA Case No. 5119, September 9, 1996, (Entry of Judgment, October 2, 1996); S.C. Johnson and Son, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 5136, May 7, 1996, (CA affirmed our decision, November 7, 1996); Armco Marsteel Alloy Corporation CTA Case No. 5115, February 6, 1996 (Entry of Judgment, February 28, 1996); Gillette (Philippines), Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4248, February 8, 1995, (Entry of Judgment, March 1, 1995); SmithKline and French Overseas Company vs. Commissioner of Internal Revenue, CTA Case No. 5048, September 22, 1995, (Entry of Judgment, January 30, 1996); IBM Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4308, March 31, 1993, (Entry of Judgment, January 17, 1994); Kimberly-Clark Corporation (U.S.A.) and Kimberly-Clark (Philippines) Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4288, January 30, 1992, (CA Entry of Judgment, September 27, 1994); and . General Electric Philippines Meter*

and Instrument Co., Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4158, December 5, 1991 (CA Entry of Judgment, January 26, 1995)

Quoted hereunder is the pertinent portion of our decision in the case of ***IBM Philippines, Inc. v. Commissioner of Internal Revenue, CTA Case No. 4308***, ***supra:***

> "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)(111) 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 the then Commissioner of Internal Revenue, Bienvenido Tan, Jr. (BIR Ruling No. 456-88, supra), that under the most favored nation provision of the RP-US 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 RP-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."

Anent respondent's argument that the US licensors are in fact and in law not entitled to the lower tax rate of 10% on royalties derived from sources within the Philippines due to the absence of a 20% matching credit available under Art. 24(b) and (c)(iii) of the R.P.-West Germany Tax Treaty, the same had likewise been resolved by this Court in the aforementioned IBM Case (CTA Resolution, July 21, 1993) and again in the more recent case of ***BASF Coatings and Inks Philippines, Inc., CTA Case No. 5135, October 1, 1996*** to quote:

> "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, CTA Records, p. 345)
>
> The applicable provision of the R.P.-U.S. Tax Treaty provides:
>
> > "Art. 13(2)(b)(iii). x x x (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 Taxation of Article 23 (Relief from Double Taxation of the R.P. - U.S. Tax Treaty, there 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, CTA 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:

(a) xxx xxx xxx

(b) Subject to the provisions of German Tax laws regarding credit for foreign tax, there shall be allowed as a tax credit against German income and corporate 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

(c) For purpose of credit referred to in subparagraph (b), the Philippine tax shall be deemed to be:

xxx xxx xxx

(iii) in the case of royalties for which the tax is reduced to 10% or 15% according to paragraph 2 of Article 12, 20% of the gross amount of such royalties. (underscoring supplied)

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 "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 "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 RP-US Tax Treaty. Article 13(2)(b)(iii) speaks of '<u>royalties</u> of the same kind paid under similar circumstances to a resident of a third state'. Nowhere does it speak, whether express or implied of <u>tax</u> paid under similar circumstances. Respondent is reading into the RP-US Tax Treaty something that is clearly

> The requirement of similar circumstances is in relation to the payment of royalty, not payment of 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 to 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, CTA Records, pp. 363-364)

We remain steadfast to the aforecited rulings, thus, the same should be applied in the case at bar. And needless to say, through the said decisions, this Court with the affirmation of the Court of Appeals had in effect overruled the provisions of Revenue Memorandum Circular No. 39-92 in favor of BIR Ruling No. 456-88.

To prove its claim for refund, petitioner presented the following pertinent evidence which were properly identified by its witnesses:

(1) Trademark License Agreement between Ralston Purina Company and the petitioner (Exh. "A");

2) Certificate of Registration No. 1240 issued by the BPTTT registering the Trademark License Agreement between Ralston Purina Company and the petitioner valid for five years from September 1, 1991 to August 31, 1996 (Exh. "C");

3) Technical Assistance Agreement between Ralston International Service Company and the petitioner (Exhs. "B");

4) Certificate of Registration No. 1268 issued by the BPTTT registering the Technical Assistance Agreement between Ralston International Service Company and the petitioner

valid for five years from September 1, 1991 to August 31, 1996 (Exh. "D");

5) BPI Applications for cashier's checks and other bank requirements for wire transfer to licensors of accumulated royalties (Exhs. "E", "G", "I", and "K",);

6) Report of Independent Accountants containing an opinion as to the fairness of the accompanying statement of royalty fee payable to the licensors (Exhs. "F", "H", "J", and "L");

7) Monthly Remittance Return of Income Taxes Withheld (Exhs. "M", and "O");

8) Official Receipts issued by BIR to petitioner evidencing payment of withholding taxes on royalties (Exhs. "N" and "P");

9) Claim for tax refund of overpaid withholding tax on royalties in the amount of P2,108,137.30 (Exh. "S");

10) Authenticated copies of Articles/Certificates of Incorporation of RPC and RISCO (Exhs. "T" and "V")

After a thorough examination of all the foregoing evidence, this Court finds that the petitioner had fully substantiated its claim of overpaid withholding tax on royalties for the period January 1, 1992 to September 30, 1993, hence, a refund is in order.

WHEREFORE, in view of all the foregoing, the instant petition is hereby **GRANTED** and respondent is ordered to refund to the petitioner the amount of P2,108,137.30 representing overpaid withholding taxes on royalties covering the period January 1, 1992 to September 30, 1993.

SO ORDERED.

AMANCIO Q. SAGA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

RAMON O. DE VEYRA
Associate Judge

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals