REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC
****

HEUNG-A SHIPPING CO., INC. represented by WALLEM PHILIPPINES SHIPPING, INC.
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. E.B. NO. 173
(C.T.A. Case No. 6672)

Present:

ACOSTA, *P.J.,*
CASTAÑEDA, JR.,
BAUTISTA,
UY,
CASANOVA, and
PALANCA-ENRIQUEZ, *JJ.*

Promulgated:

JUL 17 2006 [signature]

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DECISION

ACOSTA, PJ.:

This is a Petition for Review filed with the Court En Banc by Heung-A Shipping Co. on April 12, 2006 brought to question Decision and the Resolution both rendered by the Second Division on October 28, 2005 and February 24, 2006, respectively, in the case entitled "***HEUNG-A SHIPPING CO.,* represented by *WALLEM PHILIPPINES SHIPPING, INC. vs. COMMISSIONER OF INTERNAL REVENUE***" CTA Case No. 6672.

THE FACTS

The facts of the case are undisputed.

Petitioner is a corporation duly organized and existing under the laws of the Republic of South Korea, and is engaged in business as an international shipping carrier. It is represented in the Philippines by its duly organized shipping agent, Wallem Philippines Shipping, Inc., a domestic corporation with principal place of office at Wallem Philippines Building, Beaterio corner Legaspi Streets, Intramuros, Manila.

Respondent on the other hand, is the Commissioner of Internal Revenue, vested with, among others, the power to decide, approve and grant refunds of overpaid internal revenue taxes and holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

Although international carriers usually are subjected to a rate of two and a half (2 ½) percent on their gross Philippine Billings pursuant to Section 28 (A)(3) of the National Internal Revenue, petitioner, as a resident of the Republic of South Korea, is entitled to the preferential rate of 1 ½% tax rate by virtue of the provisions of the "*Convention between the Government of the Republic of the Philippines and the Government of the Republic of South Korea for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income*," otherwise known as the ***RP-South Korea Tax Treaty***.

Citing the "***Most Favored Nation Clause***" under the RP-South Korea Treaty, petitioner on April 14, 2003 filed an administrative claim for refund or for the issuance of tax credit certificate with respondent, in the amount of P3,260,198.69, representing erroneously paid income taxes on Gross Philippine Billings covering the years 2000, 2001 and 2002, arguing that since the residents of Cyprus are exempt from the payment of Philippine Income Taxes on profits derived from within Philippine sources on their shipping operations, pursuant to Article 12(1) of the "Agreement between the Government of the Republic of Cyprus and the Government of the Philippines on Merchant Shipping" otherwise known as the RP-Cyprus Shipping Agreement, petitioner should likewise be exempt from the payment of income taxes.

To toll the running of the prescriptive period within which to file a claim for refund, petitioner elevated the case to this Court on April 15, 2003. The case was raffled to the Second Division.

Then on October 28, 2005, the Second Division rendered its Decision dismissing the petition mainly on the ground that the Most-Favored Nation clause does not apply since the two agreements (i.e., the RP-South Korea Tax Treaty and the RP-Cyprus Shipping Agreement) pertain to two different issues and fields. For one, the RP-South Korea Tax Treaty relates to exactly to the avoidance of double taxation, while, the other (RP-Cyprus Shipping Agreement) deals with the field of merchant shipping.

On December 2, 2005, petitioner filed its Motion for Reconsideration, which the Court denied on February 24, 2006 upon finding that the grounds raised in the Motion for

Reconsideration are mere reiterations of matters already taken into consideration in the assailed Decision. Hence, this petition.

ASSIGNMENT OF ERRORS

Petitioner raises the following errors that the Court may have committed:

A. The 2nd Division of the CTA erred in rendering a Decision on an issue not raised by the respondent. The issue of similarity of subject matter between the Philippines-Korea Tax Treaty and the Philippines-Cyprus Shipping Agreement was never raised by the respondent at any time.

Parenthetically, the question on the constitutionality of the Philippines-Cyprus Shipping Agreement, which was the sole argument raised by the respondent, was already sufficiently addressed by petitioner during trial.

B. The 2nd Division of the CTA erred in raising the SC Johnson Case as basis in denying petitioner's judicial claim for refund.

C. Assuming *arguendo* that the SC Johnson case applies, the 2nd Division of the CTA erred on its ground that the Philippines-Korea Tax Treaty and the Philippines-Cyprus Shipping Agreement do not have a same similar subject matter. The Supreme Court ('SC') did not require the agreements involved in the application of the 'Most Favored Nation Clause' to be of a similar subject matter.

D. Assuming *arguendo* that the 2nd Division of the CTA correctly held that the subject matter of the agreements must be similar before a taxpayer can invoke the 'Most Favored Nation Clause', the 2nd Division of the CTA erred in concluding that the Philippines-Korea Tax Treaty and the Philippines-Cyprus Shipping Agreement do not have a similar subject matter.

E. The 2nd Division of the CTA erred on its ground that the taxes under the Philippine-Korea Tax Treaty and the Philippines-Cyprus Shipping Agreement are not 'paid under similar circumstances'

F. The 2nd Division of the CTA erred in not holding that the petitioner is entitled to the claim for refund/TCC since petitioner was able to point to a specific law granting exemption from tax and proved that it is entitled to such benefit.

THE COURT'S RULING

Petitioner maintains that it was erroneous for the Court to use as basis for the denial of its claim an issue not raised by respondent. This claim is bereft of merit.

It should be noted that it is petitioner who claims to be entitled to the benefits under the RP-South Korea Treaty (most favored nation clause) and the RP-Cyprus Shipping Agreement (exemption from tax). Hence, petitioner cannot correctly argue that the dissimilarity of the two cannot be made basis for the denial of the claim for refund. Naturally, to be able to rule on its claim, the court must look upon both the RP-South Korea Treaty and the RP-Cyprus Agreement to determine whether petitioner is entitled to the relief sought for.

Thus, as held in the assailed decision of the 2nd Division, the determination of the issue of petitioner's entitlement to the refund claimed would need an examination and a comparison of the RP-South Korea Treaty and the RP-Cyprus Shipping Agreement.

The rest of the assigned errors by petitioner have been discussed in the assailed decision of the 2nd Division. These supposed errors are likewise interrelated, hence, can be discussed together.

At the outset, it is noteworthy that the RP-South Korea was entered into by the Republic of the Philippines and the Republic of South Korea purposely for concluding a Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income. Thus, the liability of petitioner to Philippine taxes, as a corporation duly organized as existing under the laws of South Korea, has been defined not only by the National Internal Revenue, but, also by the RP-South Korea Tax Treaty.

In this regard, Article 8 of the said treaty, dictates that petitioner is liable to 1 ½% of the gross revenues derived from sources in that State, i.e. the Philippines. This is not arguable.

The question now lies on whether petitioner had erroneously paid this 1 ½% on its gross Philippine Billings, in view of Article 8 (2) (d) of the RP- South Korea Tax Treaty in relation to Article 12 of the RP-Cyprus Shipping Agreement. These articles read:

RP- South Korea Treaty

Article 8
xxx

3. Notwithstanding the provisions of paragraph 1, profits from sources within a Contracting State from the operation of ships and aircraft in international traffic may be taxed in the first mentioned State but the tax so charged shall not exceed the lesser of:

   a) one and one-half percent of the gross revenues derived from sources in that State; and

   b) the lowest rate of Philippine tax that may be imposed on profits of the ***same kind derived under similar circumstances by a resident third State***.

RP- Cyprus Shipping Agreement

Article 12

(1) Profits from the operation of shipping enterprise, registered under the laws and regulations of either of the Contracting Parties, in international traffic, including profits derived from its participation in a pool, a joint business or in an international operation agency, shall be ***taxable only in the Contracting Party where the registered office of the enterprise is situated***.

Petitioner contends that it is entitled to the tax exemption enjoyed by the residents of Cyprus, in view of the "most favored nation clause" under the above-quoted Article 8 (2) (b) of the RP-South Korea Tax Treaty. According to petitioner, considering that its profits are also derived from the operation of ships in international traffic, its profits are of the same kind and are derived under similar circumstances as those covered by the exemption from tax under the RP-Cyprus Shipping Agreement, consequently, it should likewise be exempt from Philippine taxes.

From the foregoing it appears that petitioner should be entitled to claim sought for. However a closer examination of both the RP-South Korea Tax Treaty and the RP-Cyprus Agreement reveals otherwise.

Firstly, the two, i.e., the RP-South Korea Tax Treaty and the RP-Cyprus Agreement were concluded for two different purposes. The RP-South Korea was especially for the ***"avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income"***. The other, the RP-Cyprus Shipping Agreement aims to ***"develop and promote cooperation between the Republic of the Philippines and the Republic of Cyprus in the field of merchant shipping on a mutually advantageous position in accordance with their respective needs and objectives for economic development"***.

The RP-South Korea Tax Treaty evidently intends to clear the way for the avoidance of double taxation while the RP-Cyprus Agreement was entered into with the aim of developing and promoting cooperation between the Philippines and Cyprus, in the field of merchant shipping. Thus, one deals with taxation, while the other deals with the field of merchant shipping.

In other words, while the RP-South Korea Tax Treaty relates to and has concrete provisions on taxation, the RP-Cyprus Agreement has none. The latter's concrete provisions specifically relate merchant shipping, only with a general provision on the application of tax laws on contracting parties. Since nowhere can it be found in the said RP-Cyprus Agreement that the residents of Cyprus are exempt from income tax, and following the time-honored principle that tax exemptions are not presumed, petitioner cannot use as basis for its claim for refund, the RP-Cyprus Shipping Agreement.

Further, even assuming for the sake of argument that the RP-Cyprus Agreement provides for a tax exemption, still petitioner's reliance on the "most favored nation clause" cannot serve its case.

In ***Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc. and the Court of Appeals*** *(309 SCRA 100),* the Supreme Court explained that the most favored nation clause has for its purpose the granting to a contracting party, treatment not less than favorable than that which has been extended to the "most favored" among other countries. The tax conventions, (as in this case the RP-South Korea Tax Treaty), are drafted with a view towards the elimination of international juridical double taxation. Juridical double taxation is in turn defined as the imposition of comparable taxes in two or more states on the same taxpayer in respect of the same subject matter and for identical periods.

The "most favored nation clause" of the RP-South Korea Tax Treaty provides: that the profits from sources within a Contracting State from the operation of ships and aircraft in international traffic may be taxed in the first mentioned State but the tax so charged shall not exceed the lesser of one and one-half percent of the gross revenues derived from sources in that State; and the lowest rate of Philippine tax that may be imposed on profits of the *same kind derived under similar circumstances by a resident third State*.

The similarity in the circumstances of payment of taxes is a condition for the enjoyment of the most favored nation treatment, precisely to underscore the need for equality of treatment. In the above-cited case (*Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc. and the Court of Appeals, supra),* the Supreme Court said that the essence of the principle is to allow the taxpayer in one state to avail of more liberal provisions granted in another tax treaty to which the country of residence of such taxpayer is also a party, provided that the subject matter of taxation, in that case royalty income, is the same as that in the tax treaty under which the taxpayer is liable. Thus, the Supreme Court agreed with the stand of the Commissioner of Internal Revenue that since the RP-US Treaty does not give a matching credit of 20 percent for the taxes paid to the Philippines on royalties as allowed under the RP-West Germany Treaty, S.C. Johnson cannot be deemed entitled to the 10 percent rate granted under the latter treaty for the reason that there is no payment of taxes on royalties under similar circumstances. In other words, the Supreme Court denied S.C. Johnson's claim because the two tax treaties are not the same in all respects, hence no payment of tax under similar circumstances.

In this case the RP-South Korea Tax Treaty and the RP-Cyprus Shipping Agreement do not reveal any similarity at all, they are different in all respects more so in the circumstances of payment of taxes. First of all, one is a duly ratified treaty and the other a mere agreement. Moreover, their provisions on taxation are notably distinct from each other. As above discussed, the two refer to different issues and have different characters and purposes. Taking into account the pronouncement of the Supreme Court in the S.C. Johnson case and these differences between the RP-South Korea Tax Treaty and the RP-Cyprus Shipping Agreement, it is with more reason that herein petitioner's claim be denied.

Consequently, contrary to petitioner's claim, it was not able to point to a specific law granting its exemption from tax nor was it able to prove entitlement to such benefit. Hence, to grant petitioner's claim would run counter the time-honored principle of taxation that an exemption from taxation is never presumed and that the same cannot be allowed unless granted in the most explicit and categorical language. Further, for tax exemption to be recognized, the grant must be clear and expressed; it cannot be made to rest on vague implications*(Insular Lumber Co. vs. Court of Tax Appeals, 104 SCRA 710).*

ACCORDINGLY, finding no reversible error in the assailed Decision and Resolution rendered by the 2nd Division and for petitioner's failure to prove entitlement to the tax exemption it claims, the Petition for Review is hereby **DISMISSED** for lack of merit.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Justice

WE CONCUR:

(took no part)
JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII of the Consitution, it is hereby certified that the above decision was reached in consultation with the members of the Court *En Banc* before the case was assigned to the writer of the opinion of this Court.

ERNESTO D. ACOSTA
Presiding Justice