REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

G.D. SEARLE PHILIPPINES, INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 5120

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
AUG 05 1997

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DECISION

This is a judicial claim for the refund of alleged overpaid withholding tax on royalties in the amount of P398,963.70.

Petitioner is a domestic corporation duly organized and existing under and by virtue of Philippine laws. It represents itself as a corporation existing by virtue of a License Agreement with G.D. Searle, USA, a foreign corporation domiciled in the United States, to sell and manufacture pharmaceutical products. Said license agreement, presented as Exhibit "A", provides among others, that G.D. Searle, USA, shall extend technical assistance to petitioner to enable it to manufacture and sell their pharmaceutical products here in the Philippines. Such agreement also contains a provision that the petitioner is obliged to pay G.D. Searle, USA, royalty fees equivalent to 3% of the net sales of the products in consideration of the technical assistance and other rights granted by virtue of the said agreement.

Petitioner further alleges that it paid royalty fees to G.D. Searle, USA, for the period covering January 1992 to September 1993 in the total amount of P1,994,814.00, net of withholding taxes. As a withholding agent, petitioner claims that it remitted to the Bureau of Internal Revenue the sum of P664,939.00 representing 25% of the royalty payments made pursuant to Article 13 of the RP-US Tax Treaty. Shortly thereafter, petitioner filed a claim for refund with the Bureau of Internal Revenue on June 2, 1994 alleging that it should only withhold 10% of the royalty fees and not 25% which it had originally remitted to the BIR. The overpayment of P398,963.70 representing the excess payment corresponds to the difference between the 25% tax rate it paid as opposed to a mere 10% withholding tax on royalties it was obliged to remit. This overpayment is computed as follows:

Tax Withheld (25%)	P664,939.00
Less: Tax Due at 10% rate	265,975.30
Excess Remittance	P396,963.70

Petitioner claims that Article 13(2)(b)(iii) of the RP-US Tax Treaty grants preferential treatment to residents of the US by allowing them to pay a tax rate lower than 25% imposed on royalties derived from sources within the Philippines, provided that a similar lower rate is granted by the Philippine authorities to a resident of another state by virtue of a treaty. The RP-West Germany Tax Treaty provides for a lower tax rate of 10% as provided in Article 12, paragraph 2(b).

Petitioner did not wait for a response on the claim for refund filed but instead immediately filed a petition for review with this Court on June 8, 1994. No new matters were raised in this petition other than what was already adduced in the administrative level.

Respondent, on the other hand, cited her oft-repeated line of defense by declaring that in actions for refund, the taxpayer has the burden of showing that taxes paid were erroneously or illegally collected and that tax refunds are construed strictly against the taxpayer.

The issues that confront us is whether or not the royalty fees paid to a US resident is subject to a 10% tax rate and whether or not the petitioner is entitled to the refund of P398,963.70, representing overpaid withholding tax on royalties.

Petitioner submits that under the "most favored nation" clause of the RP-US Tax Treaty in relation to the RP-West Germany Tax Treaty, the applicable tax rate is 10% instead of 25%. This was affirmed by this Court in the case entitled **IBM Philippines vs. Commissioner of Internal Revenue, CTA Case No. 4308, dated March 31, 1993.**

We are already well-acquainted with the legal issue that presently confronts Us. In a long line of cases, this Court has remained steadfast in affirming the wisdom of the ruling made by then Commissioner of Internal Revenue, Bienvenido Tan, Jr., in BIR Ruling No. 456-88, dated September 16, 1988, where he categorically declared that a 10% tax rate shall be imposable on royalties derived by a resident of the United States from sources within the Philippines pursuant to Article 13, paragraph 2(b)(iii) of the R.P.-U.S. Tax Treaty in relation to paragraph 2(b) of Article 12 found in the RP-West Germany Tax Treaty. We have consistently applied this ruling in disposing of similar issues in the following cases:

1) Rhone Poulenc Rorer Philippines, Inc. vs. The Commissioner of Internal Revenue, CTA Case No. 5179, July 29, 1997;

2) California Manufacturing Company, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 5186, June 27, 1997;

3) Unisys Australia Limited (Philippine Branch) vs. Commissioner on Internal Revenue, CTA Case No. 5151, June 24, 1997;

4) Abbot Laboratories (Philippines) vs. Commissioner of Internal Revenue, CTA Case No. 5119, September 9, 1996 (Entry of Judgment, October 2, 1996);

5) S.C. Johnson and Sons, Inc., vs. Commissioner of Internal Revenue, CTA Case No. 5136, May 7, 1996 (CA Affirmed our decision, November 7, 1996);

6) Armco Marsteel Alloy Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5115, February 6, 1996;

7) Smith Kline and French Overseas Company vs. Commissioner of Internal Revenue, CTA Case No. 5048, September 22, 1995 (Entry of Judgement, January 30, 1996);

8) Gillete (Philippines) Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4248, February 8, 1995 (Entry of Judgment, March 1, 1996);

9) IBM Philippines, Inc. vs. Commissioner Internal Revenue, CTA Case No. 4308, March 3, 1993;

10) Kimberly-Clark Corporation (USA) 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

11) General Electric Philippine Meter and Instrument Co., Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4158, December 5, 1991 (CA Entry of Judgment, May 27, 1993).

For purposes of academic discussion, We quote Article 13 of the RP-US Tax Treaty, thus:

> (1) Royalties derived by a resident of one of the Contracting States from sources within the other Contracting state may be taxed by both Contracting States.
>
> (2) However, the tax imposed by that other Contracting State shall not exceed -
>
> (a) In the case of the United States, 15 percent of the gross amount of the royalties, and
>
> (b) In the case of the Philippines, the least of,
>
> (i) 25 percent of the gross amount of the royalties;
>
> (ii) 15 percent of the gross amount of the royalties, where the royalties are paid by a corporation registered with the Philippine Board of Investments and engaged in preferred areas of activities; and
>
> (iii) 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."

Section 2(b)(iii) of the above-quoted Article 13 imposes 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. The lowest rate of tax that can be imposed is found in Article 12(2)(b) of the RP-West Germany Tax Treaty, which provides:

Article 12

Royalties

1. xxx xxx

2. However, such royalties may also be taxed in the Contracting State in which they arise, and according to the law of the State, but the tax so charged shall not exceed:

(a) 15 per cent of the gross amount of royalties arising from the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films or tapes for television or broadcasting, or

(b) 10 per cent of the gross amount of royalties arising from the use of, or the right to use, any patent, trade mark, design or model, plan, secret formula or process, or from the use of, or the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial or scientific experience.

The relevant provisions of these two tax treaties when taken together lead to the lowest tax rate of 10% that shall be imposable on royalties derived by a resident of the US from sources within the Philippines. The interrelationship of these two tax treaties also gives Us the preconditions for the 10% rate to apply because of the phrase "under similar circumstances" found in Article 13(2)(b)(iii) of the RP-US Tax Treaty earlier quoted. The first condition is that, the royalties paid must arise from the use, or the right to use, any patent, trademark, design or model plan, secret formula or process, or from the use of, or the right to use, industrial, commercial or scientific experience.

Secondly, the contract giving rise to such royalties must have been approved by Philippine competent authorities.

In the case entitled **IBM Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4308, March 31, 1993**, this Court resolved a similar issue, in this manner, thus:

> 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 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.

The above discussion directs us to the conclusion that royalties derived by a resident of the United States from sources within the Philippines is subject to the 10% tax rate and not to the rate of 25% withheld by the petitioner. In the light of the evidence presented by the petitioner, this Court is inclined to uphold petitioner's claim for refund in the amount of P398,963.70. The petitioner has satisfactorily convinced us that royalty payments made to G.D. Searle, USA, fall under the "most favored nation" clause found in the RP-US Tax Treaty in relation to the RP-West Germany Tax Treaty.

The royalties derived by G.D. Searle, USA, from G.D. Searle, Philippines, arose from the latter corporation's use of the trademarks, secret formula or process, industrial and scientific experience of the former corporation to enable it to manufacture and sell pharmaceutical products in pursuance of the License Agreement entered into between the two entities (see Exhibit "A"). Said License Agreement was duly registered with the Technology Transfer Registry of the Bureau of Patents, Trademark and Technology Transfer (Exhibit "B") signifying approval by Philippine Competent authorities. Thus, in view of the foregoing, petitioner is declared to be entitled to the amount of ₱398,963.70 as excess withholding taxes paid, from June 1992 to October 1993, computed as follows:

Royalty payments net of 25% withholding:

Period	Exh.	Amount
January 1992 to June 1992	C	₱ 489,996.00
July 1992 to September 1992	D	382,046.00
October 1992 to March 1992	E	460,673.00
April 1993 to June 1993	F	328,763.11
July 1993 to September 1993	Z	333,336.00

Total	₱1,994,814.11
Divided by	75 %
Total royalty payments	₱2,659,753.00

10% Withholding tax on royalty based on the "most favored nation clause" (₱2,659,753.00 x 10%)	₱ 265,975.30
Less payments based on RP-USA Tax Treaty:	

Month	Date	Amount	Exh.
May 1992	06-09-92	₱ 39,349.00	H
June 1992	07-09-92	10,703.00	I
July 1992	08-07-92	16,703.00	J
Aug. 1992	07-09-92	47,805.00	K
Sept. 1992	10-16-92	144,909.00	L
Sept. 1992	10-09-92	31,212.00	M
Oct. 1992	11-10-92	31,553.00	N
Nov. 1992	12-09-92	26,119.00	O
Dec. 1992	01-11-93	32,979.00	P
Jan. 1993	02-09-93	21,788.00	Q
Feb. 1993	03-10-93	18,795.00	R
Mar. 1993	04-02-93	22,324.00	S
Apr. 1993	05-07-93	38,864.00	T
May 1993	06-08-93	23,656.00	U
June 1993	07-12-93	47,067.00	V
July 1993	08-09-93	30,497.00	W
Aug. 1993	09-09-93	33,267.00	X
Sept. 1993	10-11-93	47,574.00	Y
Total		₱665,164.00	
Less Adjustment (Exh. D)		225.00	664,939.00

Overpaid Withholding Tax on Royalties	(₱ 398,963.70)

WHEREFORE, in view of the foregoing, respondent Commissioner of Internal Revenue is hereby **ORDERED to REFUND** in favor of petitioner the amount of ₱398,963.70 representing overpaid withholding taxes on royalty payments for the period June 1992 to October 1993.

SO ORDERED.

RAMON O. DE VEYRA
Associate Judge

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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 the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals