

**REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY**

FIRST DIVISION

GOLDEN ARCHES DEVELOPMENT CORPORATION
(formerly McGEORGE FOOD INDUSTRIES, INC.),
Petitioner,

C.T.A. CASE NO. 6862

Members:

- versus -

ACOSTA, Chairperson
BAUTISTA, and
CASANOVA, JJ.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

JUL 13 2007 10:00 AM

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DECISION

CASANOVA, J.:

This is a Petition for Review seeking the refund or issuance of a tax credit certificate in the amount of **TWENTY EIGHT MILLION EIGHT HUNDRED THIRTY ONE THOUSAND TWO HUNDRED SEVENTY EIGHT AND 04/100 (P28,831,278.04)** allegedly representing petitioner's erroneously overpaid final withholding tax on royalties for the period covering from January to December 2002 and January to June 2003.

Petitioner, Golden Arches Development Corporation, is a corporation duly organized and existing under and by virtue of Philippine laws, with principal office at the 17th Floor, Citibank Centre, Paseo de Roxas, Makati City. It is registered with the Bureau of Internal Revenue Large Taxpayer's District Office with Tax Identification Number (TIN) 000-121-242-000.

[Handwritten signature]

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Respondent is the duly appointed Commissioner of Internal Revenue vested by law with authority, among others, to approve and grant claims for credit or refund of overpaid or erroneously paid taxes pursuant to the provisions of the Tax Code.

On November 28, 2002, the Securities and Exchange Commission (SEC) issued a Certificate of Filing of the Articles and Plan of Merger approving the merger of McGeorge, a domestic corporation engaged in the business of operating McDonald's restaurants in the Philippines, and herein petitioner, then a separate business entity engaged in the business of acquiring and developing properties for use as McDonald's restaurants. Prior to the approval issued by the SEC, the Plan of Merger provided that the rights, privileges, power immunities, as well as, the License Agreement¹ between McGeorge and McDonald's, businesses, assets and properties, whether real or personal or mixed, including McGeorge's goodwill, trade name, liabilities, undertakings and obligations be all transferred to petitioner, with petitioner as the surviving corporation.

For the period covering the taxable years January to December 2002 and January to June 2003, petitioner duly filed its Monthly Remittance Returns of Final Income Taxes Withheld showing the following amounts as taxes withheld and remitted at the rate of 15% on its royalty payments made to McDonalds, pursuant to the provisions of the RP-US tax treaty, to wit:

Taxable Year 2002

Month	Date Remitted	Tax Base (Php)	Amount of Taxes Withheld at 15% (Php)
January	11-Feb-02	25,959,919.80	3,893,987.97
February	11-Mar-02	30,341,375.27	4,551,206.29
March	10-Apr-02	30,506,247.87	4,575,937.18
April	10-May-02	30,182,854.87	4,527,428.23
May	10-Jun-02	31,763,652.13	4,764,547.82
June	10-Jul-02	32,496,100.27	4,874,415.04
July	12-Aug-02	31,847,082.67	4,777,062.40
August	10-Sep-02	37,069,510.67	5,560,426.60
September	10-Oct-02	34,242,377.07	5,136,356.56
October	11-Nov-02	34,281,981.47	5,142,297.22
November	10-Dec-02	29,727,438.80	4,459,115.82
December	15-Jan-03	<u>37,241,539.13</u>	<u>5,586,230.87</u>
TOTAL		<u>385,660,080.02</u>	<u>57,849,012.00</u>

¹ Exhibit EEE-1

Taxable Year 2003

January	10-Feb-03	33,417,373.20	5,012,605.98
February	10-Mar-02	29,223,201.80	4,383,480.27
March	8-Apr-03	31,344,877.33	4,701,731.60
April	12-May-03	30,675,651.87	4,601,347.78
May	10-Jun-03	33,841,101.00	5,076,165.15
June	10-Jul-03	<u>32,463,275.60</u>	<u>4,869,491.34</u>
TOTAL		<u>190,965,480.80</u>	<u>28,644,822.12</u>

On January 1, 2002, the RP-China tax treaty took effect. Under Article 23 of the said tax treaty, the rate of final withholding tax on royalties paid beginning January 2002 should be taxed at the concession rate at 10%. On the opinion that it is entitled to the lower rate of 10% compliant with the "most-favored-nation" clause of the RP-US tax treaty, petitioner then filed on December 23, 2003 an administrative claim² for refund or the issuance of a tax credit certificate for the recovery of its alleged over-remitted and overpaid final withholding tax on its royalty payments to McDonalds in the amounts of P19,283,004.00 and P9,548,274.04 for the taxable periods 2002 and January to June of 2003, computed as follows:

Taxable Year 2002

Month	Tax Base (Php)	Amount of Taxes Withheld at 15% (Php)	Withholding Tax at 10% (Php)	Over remittance (Php)
January	25,959,919.80	3,893,987.97	2,595,991.98	1,297,995.99
February	30,341,375.27	4,551,206.29	3,034,137.53	1,517,068.76
March	30,506,247.87	4,575,937.18	3,050,624.79	1,525,312.39
April	30,182,854.87	4,527,428.23	3,018,285.49	1,509,142.74
May	31,763,652.13	4,764,547.82	3,176,365.21	1,588,182.61
June	32,496,100.27	4,874,415.04	3,249,610.03	1,624,805.01
July	31,847,082.67	4,777,062.40	3,184,708.27	1,592,354.13
August	37,069,510.67	5,560,426.60	3,706,951.07	1,853,475.53
September	34,242,377.07	5,136,356.56	3,424,237.71	1,712,118.85
October	34,281,981.47	5,142,297.22	3,428,198.15	1,714,099.07
November	29,727,438.80	4,459,115.82	2,972,743.88	1,486,371.94
December	<u>37,241,539.13</u>	<u>5,586,230.87</u>	<u>3,724,153.91</u>	<u>1,862,076.96</u>
TOTAL	<u>385,660,080.02</u>	<u>57,849,012.00</u>	<u>38,566,008.00</u>	<u>19,283,004.00</u>

Taxable Year 2003

January	33,417,373.20	5,012,605.98	3,341,737.32	1,670,868.66
February	29,223,201.80	4,383,480.27	2,922,320.18	1,461,160.09
March	31,344,877.33	4,701,731.60	3,134,487.73	1,567,243.87
April	30,675,651.87	4,601,347.78	3,067,565.19	1,533,782.59
May	33,841,101.00	5,076,165.15	3,384,110.10	1,692,055.05
June	<u>32,463,275.60</u>	<u>4,869,491.34</u>	<u>3,246,327.56</u>	<u>1,623,163.78</u>
TOTAL	<u>190,965,480.80</u>	<u>28,644,822.12</u>	<u>19,096,548.08</u>	<u>9,548,274.04</u>
Total over-remittance (2002 – 2003)				<u>28,831,278.04</u>

² Exhibit OO

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Having received no reply from the respondent and before it could be barred by prescription; petitioner filed this instant Petition for Review on February 9, 2004.

On March 29, 2004, respondent filed his Answer interposing the following Special and Affirmative Defenses:

4. He reiterates and repleads the preceding paragraphs of this answer as part of his Special and Affirmative Defenses;
5. Petitioner's claim for refund is still subject to the administrative routinary investigation/examination by the respondent's Bureau;
6. Taxes paid and collected are presumed to have been made in accordance with law and implementing regulations, hence, not refundable;
7. Petitioner's claim for issuance of refund/tax credit in the amount of P28,831,278.04 as alleged erroneously overpaid final withholding tax on royalties for the period January to December 2002 and January to June 2003 were not fully substantiated;
8. Assuming but without admitting the fact that petitioner is entitled to tax refund, it is incumbent upon the latter to show that it has complied with the provisions under Sections 204 in relation to Section 230 (now 229) of the Tax Code. Otherwise, its failure to prove the same is fatal to its claim for refund; and
9. Claims for refund are construed strictly against the claimant for the same partake the nature of exemption from taxation (Commissioner of Internal Revenue vs. Ledesma, 31 SCRA 95) and as such, they are looked upon with disfavor (Western Minolco Corp. vs. Commissioner of Internal Revenue, 124 SCRA 1211).

On February 13, 2007, without any Memorandum filed by respondent, this case was submitted for decision.

The parties have jointly stipulated the following as the issues for which this Court is called upon to resolve:

1. Whether or not petitioner has erroneously over-withheld and over-remitted final withholding taxes in the amount of P28,831,278.04 for the periods from January to December 2002 and January to June 2003.
2. Whether or not the said over-withheld and over-remitted final withholding taxes in the total amount of P28,831,278.04 for the periods from January to December 2002 and January to June 2003 are duly substantiated by documentary evidence. 

3. Whether or not petitioner should apply the rate of 15% or 10% in computing the final withholding taxes on royalties paid to McDonalds for the periods from January to December 2002 and January to June 2003.
4. Whether or not petitioner is entitled to the refund or tax credit in the sum of P28,831,278.04 as erroneously over-withheld and over-remitted final withholding taxes on royalties for the period from January to December 2002 and January to June 2003.

Crucial to petitioner's claim is the proper interpretation of the provisions of the RP-US, RP-Netherlands, RP-Russia tax treaties, in relation to that of the RP-China Tax Treaties, more particularly, the provisions on the rate of final taxes on royalties, which is to be imposed by the Philippines upon royalties received by a non-resident foreign corporation. For a better understanding of the provisions of the aforementioned tax treaties, the pertinent articles are hereunder quoted:

RP-US TAX TREATY

Article 13
Royalties

- 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 Contracting State shall not exceed;
 - a.) In the case of the United States, 15 per cent of the gross amount of the royalties, and
 - b.) In the case of the Philippines, the least of:
 - (i) 25 per cent of the gross amount of the royalties;
 - (ii) **15 per cent 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.**



- 3.) The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematographic film or films or tapes used for radio or television, broadcasting, any patent, trade mark, design or model, plan, secret formula or process or other like right or property, or for the information concerning industrial, commercial or scientific experience. The term "royalties" also includes gains derived from the sale, exchange or other disposition thereof."

RP-RUSSIA TAX TREATY

Article 12 Royalties

1. Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.
2. However, the royalties may also be taxed in the Contracting State in which they arise and according to the laws of the State, but the tax so charged **shall not exceed 15 per cent of the gross amount of royalties.**
3. The term "royalties" shall mean payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films and films and tapes for television or radio broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience."

RP-NETHERLANDS TAX TREATY

Article 12 Royalties

1. Royalties arising in one of the States and paid to a resident of the other State may be taxed in that other State.
2. However, such royalties may also be taxed in the State in which they arise, and according to the laws of that State, but if the recipient is a beneficial owner of the royalties the tax so charged shall not exceed:
 - (a) 10 per cent of the gross amount of the royalties where the royalties are paid by an enterprise registered, and engaged in preferred areas of activities in that State;
and 



**(b) 15 per cent of the gross amount of the royalties
in all other cases.**

3. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, and the right to use, any copyright of literary, artistic or scientific work including cinematographic films or tapes for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience."

RP-CHINA TAX TREATY

Article 12
Royalties

1. Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.
2. However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of the State, but if the recipient is the beneficial owner of the royalties, the tax so charged shall not exceed:
 - a. 15 per cent of the gross amount of royalties arising from the use of, 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.**

For as long as the transfer of technology, under Philippine Law, is subject to approval, the limitation of the tax rate mentioned under (b) shall, in the case of royalties arising in the Republic of the Philippines, only apply if the contract giving rise to such royalties has been approved by the Philippines competent authorities.

3. The term "royalties" shall mean payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.





Considering that the issues raised are intertwined, this Court deems it proper to discuss them together.

To prove its claim that it had withheld and remitted the total amount of P28,831,278.04 to respondent, representing the 15% tax rate on royalty payments, petitioner presented its Monthly Remittance Returns on Final Income Taxes Withheld (BIR Form No. 1604-F) for the periods covering January 2002 to June 2003, as well as, the corresponding authorized agent bank's official receipts³ covering the same. In addition to the aforementioned exhibits, petitioner likewise presented in evidence BIR Revenue Accounting Division's Certificate No. RAD-04-02-065⁴ which allegedly confirmed the total amounts of final withholding taxes withheld and remitted by petitioner during the period covering from January 2002 to June 2003. Accordingly, the amounts as reflected on the certificate accounts for the amounts as duly withheld and remitted by petitioner.

However, hinging on the provisions of the RP-China tax treaty which took effect on January 1, 2002, petitioner submits that there was an over-withholding and over-remitting of the subject final withholding taxes it made at 15% subject of the RP-US tax treaty on its royalty payments made to McDonald's for the period covering from January 2002 to June 2003. Petitioner avers that, pursuant to Article 12(2)(b) of the RP-China tax treaty, the royalties derived by a resident of China from sources within the Philippines shall be subject to tax at the rate of only ten percent (10%). Thus, by virtue of the "most favored nation clause" of the RP-US tax treaty, residents of the United States of America are entitled to avail of the preferential 10% tax rate on royalties derived from sources within the Philippines.

Furthermore petitioner asserts the applicability of Revenue Memorandum Circular (RMC) No. 46-02, as well as, DA-ITAD Ruling No. 105-03⁵ to its claim; that while RMC No. 

³ Exhibits A to JJ

⁴ Exhibit QQ

⁵ Exhibit RR

46-02 clarified the tax implications of Article 12(2)(b) of the RP-China tax treaty, in relation to Article 12(2)(b)(iii) of the RP-US tax treaty, DA-ITAD Ruling No. 105-03 confirmed its entitlement to the 10% tax rate under Article 12(2)(b) of the RP-China tax treaty on its royalty payments to McDonald's pursuant to the "most-favored-nation" clause. For brevity:

RMC 46-02

"Article 23 of the RP-US tax treaty and Article 23 of the RP-China tax treaty, though differently worded, plainly reveal a similarity in the provisions on relief from or avoidance of double taxation to their respective residents. Thus, the tax on royalty payments to residents of US and China are paid or accrued to the Philippines under the respective tax treaties is available as tax credit against the income tax payable in their respective countries. US residents may, therefore, invoke the preferential tax rate of 10% on royalties, accruing beginning January 1, 2002, arising in the Philippines 'from the use of, or the right to use, any patent, trademark, design or model, plan, secret formula or process,...or for the information concerning industrial, commercial or scientific experience' under the RP-China tax treaty, pursuant to the 'most-favored-nation' clause of the RP-US tax treaty."

DA-ITAD Ruling No. 105-03

"Based on the aforequoted provisions, the tax imposed 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. Relative thereto, it is noteworthy that under Article 12(b) of the RP-China tax treaty, the tax charged shall not exceed 10% of the gross amount of royalties.

Such being the case, this Office is of the opinion and so holds that the royalty payments of McGeorge to McDonald's under the License Agreement effective January 01, 2002, the date of the effectivity of the RP-China tax treaty, shall be subject to tax rate of ten percent (10%) pursuant to the RP-US tax treaty in relation to Article 12(2)(b) of the RP-China tax treaty. (*Revenue Memorandum Circular* No. 46-2002 dated September 2, 2002)(*BIR Ruling No.* DA-ITAD 101-03 dated July 24, 2003)."

A thorough examination of the case presented by petitioner would reveal that it had indeed satisfactorily proven its entitlement to the claim sought for.

Pursuant to Revenue Memorandum Circular No. 46-02, the following two requirements must be complied with before the reduced tax rate of 10% may be availed of by the taxpayer invoking the same, thus:



1. It is necessary that there be an agreement or a contract whereby the royalties paid to the US must originate 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, or the right to use, industrial, commercial or scientific experience; and
2. The contract or agreement is subject to the approval under Philippine law, the same must be duly approved by the Philippine competent authority.

To prove compliance with the requirements under the aforementioned RMC, petitioner offered in evidence the following documents, to wit:

1. Certification issued by the Intellectual Property Office covering IPO Certificate of Registration No. 5-2002-00122⁶ valid from September 1, 1993 to December 31, 2010; and
2. License Agreement and its Amendments entered into by and between the petitioner and McDonald's Corporation, duly authenticated by the Consulate General of the Republic of the Philippines for the District of Columbia.

Verily, the aforementioned documents show that both parties have agreed to the conditions set forth therein, that is, for the petitioner's payment of royalty or license fees to McDonald's Corporation for the adoption and use by petitioner of "those food and beverages which have been designated by Licensor (McDonald's), the trade names, trademarks and service marks which Licensor shall designate, from time to time, to be part of the McDonald's system"⁷.

As regards the main point in issue, it must be emphasized that the RP-US, RP-Russia, RP-Denmark, RP-Sweden and RP-China Tax Treaties are just a few of the bilateral agreements which the Philippines has entered into, for the purpose of avoiding, if not eliminating, double taxation and its effects on the national fiscal legislations of the contracting parties. Double taxation usually takes place when a person is a resident of a contracting state and derives income from, or owns capital in, the other contracting state and both states impose tax on that income or capital. More precisely, the tax convention;

⁶ Exhibit EEE

⁷ Exhibit EEE, "License Agreement"

are drafted with a view towards the elimination of international juridical double taxation, which is 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 periods⁸. For these purposes, treaties or agreements on the subject matters entered into then provide for several methods of avoiding from or eliminating double taxations' destructive effects on the free flow of goods and services, as well, as in the movement of capital, technology and persons.

In this instant case, both the Philippines, as the state of source, and the United States, as the state of residence, are permitted to tax the royalties paid by the petitioner for the adoption and right to use McDonald's food and beverages which have been designated by it, the trade names, trademarks and service marks which it shall designate, from time to time, to be part of the McDonald's system"⁹. To allow both countries to tax the royalty payments is a clear case of double taxation, thus, the applicability of the provisions of the tax treaties.

Under the RP-US tax treaty, the allowance of a tax credit to citizens or residents of the United States (in an appropriate amount based upon the taxes paid or accrued to the Philippines) against the United States tax, but such tax shall not exceed the limitations provided by United States law for the taxable year, is allowed to give relief from double taxation. On the other hand, under Article 13 thereof, the Philippines is given the choice from three rates, namely: 25% of the gross amount of royalties; 15% when the royalties are paid by a corporation registered with the Philippine Board of Investment and engaged in preferred areas of activities, or; the lowest rate of Philippine tax that may be imposed on royalties of the same kind paid under similar circumstances to a resident of the third State.

In the negotiation of tax treaties, the underlying rationale for reducing the tax rate is that the Philippines will give up a part of the tax in the expectation that the tax given up for

⁸ Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc., G.R. No. 127105, June 25, 1999

⁹ Exhibit EEE, "License Agreement"



this particular investment is not taxed by the other country¹⁰. The Philippines gives consideration to the fact that investments are necessary for the growth of the country and foreign investments will only "thrive in a fairly predictable and reasonable international investment climate", and what other way to attract investments than to provide for tax incentives which prevent double taxation. By avoiding double taxation, foreign investors invest in the Philippines. Thus, in this regard, the phrase "paid under similar circumstances" under the "most favored nation clause" has been construed as referring to the manner of payment of taxes or "circumstances which are tax-related", and not to the subject matter of the tax. In construing the same, the purpose of entering into a tax treaty which is to grant incentives to the foreign investors by lowering the taxes and at the same time applying against the domestic tax abroad a figure higher than what was collected here in the Philippines, is met.

In the leading case of **Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc.**¹¹, the Supreme Court interpreted the "most favored nation clause", particularly the phrase "paid under similar circumstances", as referring to the manner of payment of tax, and not to the subject matter of the tax, which is "royalties", thus:

"The purpose of a most favored nation clause is to grant to the contracting party the treatment not less favorable than that which has been or may be granted to the "most favored" among other countries. The most favored nation clause is intended to establish the principle of equality of international treatment by providing that the citizens or subjects of the contracting nations may enjoy the privileges accorded by either party to those of the most favored nation. 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 this case royalty income, is the same as that in the tax treaty under which the taxpayer is liable. Both Article 13 of the RP-US Tax Treaty and Article 12 (2)(b) of the RP-West Germany Tax Treaty, above-quoted, speaks of tax on royalties for the use of trademark, patent and technology. The entitlement of the 10% rate by U.S. firms despite the absence of a matching credit (20% on royalties) would derogate from the design behind the most favored nation clause to grant equality or international treatment since the tax burden laid

¹⁰ Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc. and CA, G.R. No. 127105, June 25, 1999

¹¹ Supra.

upon the income of the investor is not the same in the two countries. The similarity in the circumstances of payment of taxes is a condition for the enjoyment of most favored nation treatment precisely to underscore the need for equality of treatment."

This being so, the provisions of the RP-US, RP-Russia and RP-China Tax Treaties pertaining to royalties should then be read together with the provisions on the Avoidance or Relief from Double Taxation. Pertinent provisions of the three treaties are quoted for easy reference, to wit:

RP-US TAX TREATY

Article 23 Relief from double taxation

Double taxation of income shall be avoided in the following manner:

1. In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle thereof), the United States shall allow to a citizen or resident of the United States as a credit against the United States tax the appropriate amount of taxes paid or accrued to the Philippines and, in the case of a United States corporation owning at least 10 per cent of the voting stock of a Philippine corporation from which it receives dividends in any taxable year, shall allow credit for the appropriate amount of taxes paid or accrued to the Philippines by the Philippine corporation paying such dividends with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of tax paid or accrued to the Philippines, but the credit shall not exceed the limitations (for the purpose limiting the credit to the United States tax on income from sources within the Philippines or on income from sources outside the United States) provided by United States law for the taxable year. For the purpose of applying the United States credit in relation to taxes paid or accrued to the Philippines, the rules set forth in Article 4 (Source of Income) shall be applied to determine the source of income. For purposes of applying the United States credit in relation to taxes paid or accrued to the Philippines, the taxes referred to in paragraphs (a)(b) and (2) of Article 1 (Taxes Covered) shall be considered to be income taxes.
2. In accordance with the provisions and subject to the limitations of the law of the Philippines (as it may be amended from time to time without changing the general principle hereof), the Philippines shall allow to a citizen or resident of the Philippines as a credit against the Philippine tax the appropriate amount of taxes paid or accrued to the United States and, in the case of a Philippine corporation owning at least 5 per cent of the voting stock of a United States corporation

from which it receives dividends in any taxable year, shall allow credit for the appropriate amount of taxes paid or accrued to the United States by the United States corporation paying such dividends with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of tax paid or accrued to the United States, but the credit shall not exceed the limitations (for the purpose limiting the credit to the Philippines tax on income from sources within the United States and on income from sources outside the Philippines) provided by Philippines law for the taxable year. For the purpose of applying the Philippines credit in relation to taxes paid or accrued to the United States, the rules set forth in Article 4 (Source of Income) shall be applied to determine the source of income. For purposes of applying the Philippines credit in relation to taxes paid or accrued to the United States, the taxes referred to in paragraphs (1)(a) and (2) of Article 1 (Taxes Covered) shall be considered to be income taxes.

RP-RUSSIA TAX TREATY

Article 23

Relief from Double Taxation

In the case of the Philippines, double taxation shall be avoided in the following manner:

Subject to the provisions of the laws of the Philippines relating to the allowance as credit against Philippine tax of tax payable in any country other than the Philippines, income taxes paid or have accrued under the laws of the Russian Federation and in accordance with this Convention, whether directly or by deduction, in respect of income from sources within the Russian Federation shall be allowed as a credit against Philippines tax payable in respect of that income.

In the case of a Philippine corporation owning more than 50 per cent of the voting stock of a Russian company from which it receives dividends in any taxable year, the Philippines shall also allow credit for the appropriate amount of taxes paid or accrued in the Russian Federation to a Russian company paying such dividends with respect to the profits out of which such dividends are paid. The deduction shall not, however, exceed that part of the Philippine income tax, as computed before the deduction is given, which is appropriate to the income which may be taxed in the Russian Federation;

In the case of the Russian Federation, double taxation shall be avoided in the following manner:

Where a resident of the Russian Federation derives income from the Philippines, the amount of tax of that income payable in the Philippines in accordance with the provisions of this Convention, may be credited against the tax levied in the Russian Federation imposed on that resident. The amount of credit, however, shall not exceed the amount of the Russian tax on that income computed in accordance with taxation laws and regulations of the Russian Federation. 

RP-CHINA TAX TREATY

Article 23

Methods for the Elimination of Double Taxation

1. In the Philippines, double taxation shall be eliminated as follows:

Subject to the laws of the Philippines and the limitations thereof regarding the allowance of a credit against Philippine tax of tax payable in any country other than the Philippines. Chinese tax payable in respect of income derived from China shall be allowed as credit against the Philippine tax payable in respect of that income.

2. In China, double taxation shall be eliminated as follows:

Where a resident of China derives income from the Philippines the amount of tax on that income payable in the Philippines in accordance with the provisions of this Agreement, may be credited against the Chinese tax imposed on that resident. The amount of the credit, however, shall not exceed the amount of the Chinese tax on that income computed in accordance with the taxation laws and regulations of China."

Evidently, based on the foregoing, the rates of 15% and 10% as provided under the RP-Russia and RP-China Tax Treaties, respectively, should apply only if the taxes imposed upon royalties in the RP-US Tax Treaty, RP-Russia Tax Treaty and RP-China Tax Treaty are paid under similar circumstances. Under Article 23 (1) & (2) on Relief from Double Taxation of the RP-US Tax Treaty, it is provided that the allowable foreign tax credit under the treaties is the appropriate amount of taxes actually paid or accrued to the Philippines. Although various tax treaties already in force would show dissimilar provisions on the relief from or avoidance of double taxation as this is a matter of negotiations between the contracting states, a cursory reading of the RP-Russia and RP-China Tax Treaties reveals similar provisions on the relief from or avoidance of double taxation as those stipulated in the RP-US Tax Treaty. In other words, the three treaties deal with the method of payment by allowing a credit of the foreign tax as against the taxes actually paid in the Philippines, which is considered as paid under similar circumstances.



As earlier discussed, the purpose of the most favored nation clause is to grant to the contracting state treatment not less favorable than that which has been or may be granted to the "most favored" among other countries. And this is definitely intended to establish the principle of equality of international treatment by providing that the citizens or subjects of the contracting nations may enjoy the privileges accorded by either party to those of the most favored nation.¹²

Moreover, BIR Ruling DA-ITAD No. 105-003 issued by the International Tax Affairs Division of the BIR, through its Assistant Commissioner for Legal Service Milagros V. Regalado on July 28, 2003, supports this Court's findings on the matter, to wit:

"Based on the foregoing provisions, the tax imposed 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. Relative thereto, it is noteworthy that under Article 12(b) of the RP-China tax treaty, the tax charged shall not exceed 10% of the gross amount of royalties.

Such being the case, this Office is of the opinion and so holds that the royalty payments of McGeorge to McDonald's under the License Agreement effective January 1, 2002, the date of the effectivity of the RP-China tax treaty, shall be subject to a tax rate of ten percent (10%), pursuant to the RP-US tax treaty in relation to Article 12(2)(b) of the RP-China tax treaty. (Revenue Memorandum Circular No. 46-2002 dated September 2, 2002) (BIR Ruling No. DA-ITAD 101-03 dated July 24, 2003)."

Clearly then, the provisions of the RP-China Tax Treaty, more particularly, the reduced tax rate on royalties at 10%, should apply to petitioner.

As regards now to the amount of the alleged overpayment, petitioner submits that it actually withheld and remitted the total amount of P86,493,834.12 (P576,625,560.82 x 15%) for the periods covering from January 2002 to June 2003 as withholding taxes on its royalty payments to McDonald's Corporation, per its Monthly Remittance Returns. However, pursuant to the provisions of the RP-US and RP-China tax treaties, it should only withhold

¹² supra

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and remit the amount of P57,662,556.08 (P576,625,560.82 x 10%) based on the tax rate of 10%.

After an examination of petitioner's Monthly Remittance Returns for the period January 2002 to June 2003, with their corresponding bank receipts/statements, and the testimonies of its witnesses, this Court finds petitioner's claim as to the amount of refund in order. Thus, based on the applicable tax rate of ten percent (10%), petitioner only owes the Government of the Philippines the final taxes on royalty in the amount of P57,662,556.08 pursuant to the RP-China Tax Treaty. Consequently, petitioner over-withheld and over-paid the amount of P28,831,278.04 (P86,493,834.12 – 57,662,556.08). For clarity:

Taxable Year 2002

<u>Month</u>	<u>Tax Base (Php)</u>	<u>Amount of Taxes Withheld at 15% (Php)</u>	<u>Withholding Tax at 10% (Php)</u>	<u>Over remittance (Php)</u>
January	25,959,919.80	3,893,987.97	2,595,991.98	1,297,995.99
February	30,341,375.27	4,551,206.29	3,034,137.53	1,517,068.76
March	30,506,247.87	4,575,937.18	3,050,624.79	1,525,312.39
April	30,182,854.87	4,527,428.23	3,018,285.49	1,509,142.74
May	31,763,652.13	4,764,547.82	3,176,365.21	1,588,182.61
June	32,496,100.27	4,874,415.04	3,249,610.03	1,624,805.01
July	31,847,082.67	4,777,062.40	3,184,708.27	1,592,354.13
August	37,069,510.67	5,560,426.60	3,706,951.07	1,853,475.53
September	34,242,377.07	5,136,356.56	3,424,237.71	1,712,118.85
October	34,281,981.47	5,142,297.22	3,428,198.15	1,714,099.07
November	29,727,438.80	4,459,115.82	2,972,743.88	1,486,371.94
December	<u>37,241,539.13</u>	<u>5,586,230.87</u>	<u>3,724,153.91</u>	<u>1,862,076.96</u>
	<u>385,660,080.02</u>	<u>57,849,012.00</u>	<u>38,566,008.00</u>	<u>19,283,004.00</u>
Taxable Year 2003				
January	33,417,373.20	5,012,605.98	3,341,737.32	1,670,868.66
February	29,223,201.80	4,383,480.27	2,922,320.18	1,461,160.09
March	31,344,877.33	4,701,731.60	3,134,487.73	1,567,243.87
April	30,675,651.87	4,601,347.78	3,067,565.19	1,533,782.59
May	33,841,101.00	5,076,165.15	3,384,110.10	1,692,055.05
June	<u>32,463,275.60</u>	<u>4,869,491.34</u>	<u>3,246,327.56</u>	<u>1,623,163.78</u>
	<u>190,965,480.80</u>	<u>28,644,822.12</u>	<u>19,096,548.08</u>	<u>9,548,274.04</u>
TOTAL		<u>86,493,834.12</u>	<u>57,625,556.08</u>	<u>28,831,278.04</u>

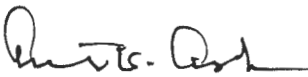
IN VIEW OF THE FOREGOING, the subject Petition for Review is hereby **GRANTED**. Accordingly, respondent is **ORDERED TO REFUND** or in the alternative,

ISSUE A TAX CREDIT CERTIFICATE in favor of petitioner in the amount of **TWENTY EIGHT MILLION EIGHT HUNDRED THIRTY ONE THOUSAND TWO HUNDRED SEVENTY EIGHT AND 04/100 PESOS (P28,831,278.04)** representing petitioner's over-withheld and over-paid final taxes on royalties for the period covering January 2002 to June 2003.

SO ORDERED.


CAESAR A. CASANOVA
Associate Justice

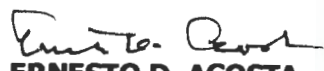
WE CONCUR:


ERNESTO D. ACOSTA
Presiding Justice


LOVELL R. BAUTISTA
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.


ERNESTO D. ACOSTA
Presiding Justice
Chairman, First Division