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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

AMALGAMATED SPECIALTIES CORPORATION,
Petitioner,

- versus -

C.T.A. CASE NO. 5105

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
JUL 08 1996

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DECISION

This is a judicial claim for refund of the amount of P316,668.44 allegedly representing overpaid withholding tax on royalties remitted by petitioner to Eberhard Faber, Inc., U.S.A. and Binney and Smith, Inc., both organized and existing under the laws of the State of Delaware, U.S.A..

The antecedent facts are as follows:

Petitioner is a domestic corporation engaged and existing under the laws of the Republic of the Philippines. It is registered with the Board of Investments (BOI) as a preferred non-pioneer enterprise under Republic Act No. 5186 for the manufacture and export of pencils, crayolas, carbon papers, and typewriter ribbons.

In line with its business, petitioner entered into a Technical Licensing Agreement with Eberhard Faber, Inc. and was granted, among others, technical know-how and license to use the trademarks owned by the latter corporation, which are needed in its production of products, such as, Eberhard Faber, Mongol, Mongol Tip, Touch and Go, etc..

Likewise, petitioner entered into a Technical Assistance Agreement and Trademark Agreement with Binney and Smith, Inc. availing of technical assistance and the use of trademarks in its manufacture of crayons, chalks, and watercolors for products such as Crayola, Crayolet and Playtime.

In consideration thereof, petitioner pays Eberhard Faber, Inc. a technical fee computed at two percent (2%) of net sales, and on the part of Binney and Smith, Inc., a technical fee of one percent (1%) of net sales and another one percent (1%) of net sales as royalty fee for the use of trademarks, in all the licensed products it is able to sell.

The above agreements are duly registered with and approved by the Technology Transfer Board of the Department of Trade and Industry.

On February 24, 1994, petitioner filed its letter, dated February 23, 1994, with the Appellate Division of the Bureau of Internal Revenue, claiming for tax credit/refund the sum of P316,668.44 as overpaid withholding tax on royalties for the period January, 1992 to September, 1993. The amount allegedly represents the difference between the total withholding taxes actually remitted to the BIR for said period (P950,005.31) and the tax that it should have legally withheld and remitted (P633,336.87) using the correct tax rate of ten percent (10%). (p. 4, Memorandum for the Petitioner; p. 193, CTA records).

Petitioner asserts that respondent had erroneously imposed the 15% tax rate applicable to a BOI registered enterprise, inasmuch as it is entitled to the preferential rate of 10% by authority of the RP-US Tax Treaty in relation to the RP-West Germany Tax Treaty and, on the strength of this Court's decision and resolution in **IBM Philippines, Inc. vs. The Commissioner of Internal Revenue**, CTA Case No. 4308, March 31, 1993 and July 21, 1993, respectively.

Previously, the BIR issued Revenue Memorandum Circular No. 39-92 (RMC No. 39-92), dated July 1, 1992, where it held that the applicable withholding tax rate on royalty payments under the RP-US Treaty should be fifteen percent (15%), instead of 10 percent (10%). Accordingly, within the time allowed for amendment by the circular, petitioner filed an Amended Return for the period January, 1992 to July, 1992 and paid the deficiency of five percent (5%) amounting to P104,246.17 on August 24, 1992. (Exhibit "Q") Thereafter, it applied the fifteen percent (15%) tax rate on its subsequent royalty remittances.

Mindful of the two-year prescriptive period within which a taxpayer may claim a refund or tax credit as provided under Section 230 of the Tax Code, and with the respondent neither having approved nor denied the claim for refund, petitioner moved to protect and preserve its right by way of a judicial claim.

Hence, on April 26, 1994, petitioner filed the instant petition for review. Later, on May 10, 1994, it filed an amended petition before any responsive pleading was served by the respondent.

In answer to the amended petition, respondent specifically denied, inter alia, the applicability of the aforecited treaties and this Court's decision in IBM Phils., Inc. to the case at bar. She claims that although Article 12(2)(b) of the RP-West Germany Tax Treaty imposes a lower rate of ten percent (10%) to royalties derived from services within the Philippines, which provision should entitle petitioner to the most favored nation rate of ten percent (10%) under Article

13(2)(b)(iii) of the RP-US Tax Treaty which equally grants said rate only if the tax is paid "under similar circumstances to a resident of a Third State," it (RP-West Germany Tax Treaty), nevertheless provides for a unique matching tax credit of twenty percent (20%) of the gross amount of royalties, under Article 24(b)(dd); (c)(cc) thereof, thus resulting in <u>dissimilar</u> circumstances. (Answer, first par., p. 4; p. 44, CTA records)

She further contends that rulings earlier issued by her Bureau allowing the preferential rate of ten percent (10%) to recipients of royalties in the United States on account of the RP-West Germany Tax Treaty have already been revoked effective January 21, 1992 under RMC No. 39-92.

At this juncture, it is worthy to note that then Commissioner of Internal Revenue Bienvenido Tan, Jr. issued BIR Ruling No. 456-88 which is deemed revoked by RMC No. 39-92, confirming the opinion of IBM Phils., Inc. to the effect that under the most favored nation provision of the RP-US Tax Treaty, in consonance with the RP-West Germany Tax Treaty, royalties arising in the Philippines and payable should be taxed at the rate of ten percent (10%). Despite the ruling, however, IBM Phils., Inc. was constrained to seek remedy before this

Court due to the inaction of the respondent. The corporation was eventually granted its claim for refund.

Records show that petitioner formally offered in evidence the following documents to prove its claim, namely: a) BOI Certificate of Registration No. 70-20(E) dated February 24, 1970, b) Technical Licensing Agreement with Eberhard Faber, Inc., U.S.A., c) Amended Technical Assistance and Trademark Agreements with Binney and Smith, Inc. together with their respective Certification of Authentication, d) Bureau of Patents, Trademarks, and Technology Transfer Certificate of Registration for each of the agreements mentioned, e) Monthly Remittance Returns of Income Taxes Withheld (BIR Form No. 1743W) together with a schedule of withholding tax on royalties for the period January, 1992 to September, 1993, f) letter claim for refund dated February 23, 1994, g) Certification issued by the Revenue Accounting Division of the BIR, dated September 26, 1994 showing payments made on the Monthly Remittance Return of Income Taxes Withheld for the period January, 1992 to September, 1993, and, h) Schedule of tax returns/ATAPs Batch Control System for the months of October, 1992 and January, 1993.

In her comment, respondent presented no objection, among others, to the existence of the above certification issued by the BIR but objected as to its purpose since the document failed to state whether the amount received were for royalty payments. On petitioner's monthly remittance returns, respondent objected as to their admissibility for not being properly identified and for the purpose they are offered because the best evidence of payment are BIR's certification to that effect.

The issue to be resolved thus center on the following matters:

a) Whether or not petitioner is legally entitled to the ten percent (10%) withholding tax on royalties as provided under the RP-US Tax Treaty, in consonance with the RP-West Germany Tax Treaty; and, if in the affirmative;

b) Whether or not petitioner has established the requisite facts necessary to support its present claim for refund.

We rule in favor of the petitioner in both issues.

At the outset, let it be underscored that the legal arguments invoked by respondent had already been resolved before by this Court in the abovecited **IBM Phils., Inc. vs. Commissioner of Internal Revenue** case, and are therefore entirely devoid of merit. For expediency, we are citing the pertinent parts of our decision in said case, to wit:

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 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 RP-US Tax Treaty.

On the allegation of respondent 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 under such situation, the payment of tax on royalties is not "under similar circumstances," this Court had, likewise, passed upon the controversy in our Resolution, dated July 21, 1993, under CTA Case No. 4308. We ruled in this wise:

> 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 <u>paid under similar circumstances</u> 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), <u>there is no such tax credit</u> 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.-Gernmany 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 per cent according to paragraph 2 of Article 12, 20 per

> cent 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 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 reference to the payment of tax." (Opposition, C.T.A. Records, pp. 363-364)

On the second issue, a careful examination of the documents presented by petitioner clearly reveals that it has sufficiently proven the facts of its case. Through the returns and BIR certification, it was able to establish its payment of the excess royalty taxes sought to be refunded.

The contention of the respondent that the BIR certification (Exh. "AI") failed to state the specific amount received by BIR for royalty payments is not well-taken. The amounts indicated therein correctly tallies with both the total amount declared to be remitted, and its corresponding machine validation thereof in the individual monthly remittance returns submitted by petitioner.

On the face of each monthly return, the amount of royalty payment is specifically indicated under Schedule 2 on final tax at the backpage thereof.

While the marked exhibits of the monthly returns for January to July, 1992 (Exhibits "J" to "P") have blank backpages, which seem to leave us in the dark as to the actual nature of the amount of the final tax as indicated in Section A of each of the returns on Summary of Tax Withheld for Remittance, this Court is nonetheless convinced that said amount pertains to royalty payments. A cross-reference with the amended monthly remittance return (Exhibit "Q") filed by the petitioner and its schedule of royalty payments for the same period (Exhibit "AG") which was objected to by respondent solely on legal grounds but not as to its existence, proves the fact that such amounts are final taxes on royalty payments. Moreover, the series of monthly final tax payments of the petitioner covering the whole period of the claim consistently reveal that it only pays taxes on royalties paid to Binney and Smith, Inc., U.S.A. and Eberhard Faber, Inc.

As regards the rest of objections of respondent that the returns are not properly identified and that the best evidence of payment is a BIR certification to the effect, evidence on record peremptorily refutes such objections.

Suffice it to say, all of the returns have been properly marked and duly admitted by the Court. Although petitioner failed to sub-mark in particular the words and figures appertaining to royalty payments, still the Court can appreciate any content of said returns as they have been admitted as evidence for the petitioner.

The other objection of respondent has been satisfied by the BIR Certification on royalty payments submitted by the petitioner. (Exhibit "AI"). As discussed, the payment received by BIR conforms with the total monthly amount indicated to be remitted to the BIR under Section A of the returns. Such monthly amount is further broken down into two categories, one for creditable tax and the other for final tax, which, in fine, brings us to the conclusion that final taxes on royalties have indeed been paid to the BIR.

In summary, the individual monthly remittance returns covering the period January, 1992 to September, 1993 show the following figures (Exhibit "AG"):

Withholding Tax On Royalties
A. Covering the period January to July, 1992
Pursuant to RMC No. 39-92 dated July 1, 1992

PERIOD	(10%) B. & SMITH	(10%) E. FABER	(5%) INCREMENT	TOTAL
January	3,879.24	19,913.46	11,896.36	35,689.05
February	7,736.06	21,994.59	14,865.32	44,595.97
March	10,334.54	25,513.91	17,924.23	53,772.67
April	20,743.04	23,172.45	21,957.74	65,873.23
May	11,316.07	22,174.56	16,745.31	50,235.94
June	4,520.82	24,168.79	14,344.80	43,034.41
July	2,974.10	10,050.73	6,512.41	19,537.24

B. Covering the period August, 1992 to September, 1993 based on 15% tax rate pursuant to RMC No. 39-92

PERIOD	(15%) B. & SMITH	(15%) E. FABER	TOTAL
August 1992	283.12	4,158.34	4,441.46
September	4,610.77	35,873.91	40,484.68
October	7,557.76	55,098.34	62,656.10
November	7,362.79	53,461.47	60,824.26
December	2,610.07	17,640.40	20,250.47
January 1993	11,441.45	31,183.07	42,624.52
February	8,644.24	42,147.97	50,792.21
March	25,022.82	55,221.14	80,243.96
April	27,156.38	67,260.52	94,416.90
May	15,252.22	62,674.04	77,926.26
June	21,016.87	22,512.39	43,529.26
July	5,438.24	14,916.61	20,354.85
August	6,551.76	18,628.19	25,179.95
September	4,727.62	8,814.28	13,541.90
Total Amount Remitted (15%) A+B			950,005.29
Correct Amount to be Remitted (10%)			633,336.87
AMOUNT FOR REFUND			316,668.42

WHEREFORE, in view of the foregoing premises, respondent is hereby ordered to **REFUND** or issue a **TAX CREDIT CERTIFICATE** in favor of the petitioner the amount of **P316,668.44** representing excess payments of withholding tax on royalties, for the period covering January, 1992 to September, 1993. No cost.

SO ORDERED.

RAMON O. DE VEYRA
Associate Judge

I CONCUR:

ERNESTO D. ACOSTA
Presiding 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