REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

JARDINE DAVIES, INC,
and MACWHYTE COMPANY,
a Division of AMSTED
INDUSTRIES, INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 5141

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

Promulgated:
APR 23 1996

x - x

DECISION

This is a judicial claim for the refund of alleged overpaid withholding tax on royalty payments in the sum of P156,909.00 covering the years 1988, 1989, 1990 and 1991.

Petitioner is a corporation duly organized and existing under and by virtue of the laws of the Philippines. It remits royalty payments to Macwhyte Company, a division of Amsted Industries, a corporation duly organized and existing under and by virtue of the laws of the State of Delaware, USA.

For the period covering the years 1988, 1989, 1990 and 1991, petitioner Jardine Davies, Inc. withheld income taxes at the rate of 10% on the royalty payments remitted to Macwhyte Company. On October 30, 1992, petitioner remitted to the BIR an additional amount of P156,909.00, representing the difference between the "most favored nation clause" tax rate of 10% and 25% tax rate under Article 13(b)(i) of the RP-US Tax Treaty on the royalties it remitted during the aforesaid years. This payment is evidenced by Authority to Accept Payment No. 62482 (Exhibits "E" and "E-1"). The additional amount of P156,909.00 was paid pursuant to a directive embodied in Revenue Memorandum Circular No. 39-92, enjoining all concerned to pay the correct taxes of 25% on royalty payments made to corporations domiciled in the USA and not 10% as earlier imposed. As this circular declared that taxpayers have only until October 30, 1992 to pay the difference between the 10% and 25% tax rates otherwise penalties shall be charged, petitioner paid the difference of P156,909.00 on October 30, 1992. Consequently, petitioner filed a claim for refund of this additional amount on August 26, 1993, in reference to this Court's decision in the case entitled **IBM Philippines, Inc. vs. Commissioner of Internal Revenue**, CTA Case No. 4308, March 31, 1993, which upheld the 10% tax rate on royalties instead of the 25%. Respondent did not act upon this claim for refund hence petitioner sought recourse to this Court to stop the running of the prescriptive period provided by law in claiming for a refund of taxes.

Respondent by way of an Answer presented the following Special and Affirmative Defenses, thus:

> 4. The petition states no cause of action as it does not state the specific date/s when the alleged withholding tax of P261,514.00 allegedly representing 25% withholding tax on the total royalties of P1,046,054.00 actually paid and remitted by petitioner Jardine Davies, Inc. to Macwhyte Corporation covering the years 1988 to 1991 were collected;
>
> 5. The amount of P156,909.00 herein sought to be refunded was collected and paid in accordance with the provision of the Tax Code and the pertinent BIR rules and regulations, hence, not refundable;
>
> 6. Petitioner failed to show that the amount of P261,514.00 corresponding the 25% withholding tax on the royalties of P1,046,054.00 remitted by petitioner Jardine Davies, Inc. to Macwhyte Corporation was actually withheld, paid and remitted to the respondent Bureaus;
>
> 7. Macwhyte Company, the recipient of the royalties from which the subject withholding tax was deducted, being a resident of the U.S.A., the RP-West Germany Tax Treaty, invoked by petitioner in IBM Philippines, Inc. vs. Commissioner of Internal Revenue, case is not applicable but the RP-US Tax Treaty which imposes a 25% tax on the gross amount of royalties as provided in Article 13(2)(a)(i) thereof;
>
> 8. The "most favored nation" doctrine under Article 12(2)(b)(iii) of the RP-US Tax Treaty which was applied in the IBM Philippines case can no longer be invoked by petitioner after the passage of Revenue Memorandum Circular No. 39-92 on July 1, 1992 which revoked the availment of the benefit under it;
>
> 9. Withholding taxes should be withheld on royalties at the time of its accrual in

1988, 1989, 1990 and 1991, and not at the time of its actual remittance thereto to petitioner Macwhyte Company (Construction Resources of Asia v. Commissioner of Internal Revenue, C.T.A. Case No. 3307, November 25, 1983; Western Palawan Timber Corp. vs. Commissioner of Internal Revenue, C.T.A. Case No. 2544, June 5, 1987), hence, petitioner's claim for refund herein has already prescribed;

10. Claims for refund are construed strictly against the claimant, the same being in the nature of an exemption from taxes. (Manila Electric Co. vs. Commissioner of Internal Revenue, 67 SCRA 35) It is incumbent upon petitioner to prove that they are entitled to the herein claim for refund;

11. Well-settled is the rule that one who claims to be exempted from payment of a particular tax must do so under clear and unmistakable terms found in the statute (Asiatic Petroleum vs. Llanes, 49 Phil. 466-471; Philippine Acetylene Co., Inc. vs. Commissioner of Internal Revenue, August 17, 1967, 20 SCRA 1056). Failure on the part of petitioner to do so is fatal to its claim for refund;

12. Moreover, it is incumbent upon petitioner to show that it has complied with the provisions of Section 230 of the Tax Code.

The issues raised are the following:

1) Whether or not petitioner's right to claim for a refund of taxes on royalty payments has already prescribed;

2) Whether or not petitioner is entitled to the claim for refund of P156,909.00 pursuant to the "most favored nation clause" as provided in Article

13(2)(b)(iii) of the RP-US Tax Treaty in relation to Article 12(2)(b) of the RP-West Germany Tax Treaty.

The issue of prescription raised by respondent presents a pivotal question and we find it apt to tackle it first before going to the other issue presented.

Respondent holds the view that withholding tax on royalties should be withheld on royalty payments at the time of its accrual and not at the time of its actual remittance. In the instant case, respondent opines that royalty payments should have been withheld in the years 1988, 1989, 1990 and 1991 thus petitioner's claim for refund filed only on August 26, 1993, and the subsequent judicial claim filed on August 25, 1994, has already prescribed.

The above argument propounded by respondent without the benefit of a solid explanation presents an obscure point of view leading us to surmise that it is the government's stand that the counting of the prescriptive period of claiming a refund of taxes on royalty payments should be counted from the time of its accrual in 1988, 1989, 1990 and 1991, thus the claim for refund filed on August 26, 1993, is already beyond the 2-year period prescribed by law.

We do not subscribe to the foregoing view because the argument and the corresponding conclusion does not jibe with the actual circumstances of this case. The subject of the present claim for refund is the additional payment made by the petitioner in the amount of P156,909.00 which represents the difference between the 10% tax rate earlier paid by petitioner on the royalty payments during the years 1988, 1989, 1990 and 1991 and the 25% tax rate imposed under Revenue Memorandum Circular 39-92 dated July 1, 1992. The difference amounting to P156,909.00 was paid by petitioner pursuant to a later Revenue Memorandum Circular effectively reversing a previous BIR Ruling No. 456-88 imposing a 10% tax rate and which was relied upon by the petitioner during the years involved. This additional amount, subject of the present claim for refund, was paid on October 30, 1992 pursuant to the aforementioned circular. So it follows that in reference to the date of payment of the additional amount, the subsequent claim for refund filed by the petitioner with the BIR on August 26, 1993 and the judicial claim with this Court filed on August 25, 1994 still fall within the two-year prescriptive period prescribed by Sections 204 and 230 of the Tax Code which provides the following:

> Sec. 204. xxx xxx xxx
>
> (3) Credit or refund of taxes erroneously or illegally received, penalties imposed

> without authority, refund the value of internal revenue stamps when they are returned in good condition by the purchaser, and, in his discretion, redeem or change unused stamps that have been rendered unfit for use and refund their value upon proof of destruction. <u>No credit or refund of taxes or penalties shall be allowed unless the taxpayer files in writing with the Commissioner a claim for credit or refund within two years after the payment of the tax or penalty.</u> (Underscoring supplied)

> Section 230. *Recovery of tax erroneously or illegally collected.* - No suit or proceeding shall be maintained in any court for the recovery of any national internal revenue tax hereafter alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Commissioner; but such suit or proceeding may be maintained, whether or not such tax, penalty, or sum has been paid under protest or duresss.

> In any case, no such suit or proceeding shall be begun after the expiration of two years from the date of payment of the tax or penalty regardless of any supervening cause that may arise after payment: *Provided, however,* That the Commissioner may, even without a written claim therefor, refund or credit any tax, where on the face of the return upon which payment was made, such payment appears clearly to have been erroneously paid.

The other issue presented to this Court for resolution is whether or not the withholding tax on royalty payments remitted by petitioner falls under the "most favored nation" clause of the RP-US Tax Treaty in relation to RP-West Germany Tax Treaty subjecting such royalty payments to only 10% instead of the 25% tax rate earlier imposed.

Petitioner invoked the decision of this Court in the case entitled **IBM Philippines, Inc. vs. CIR,** CTA Case No. 4308 dated March 31, 1993 where it was declared that royalties paid to a resident of the USA is subject to a withholding tax rate of 10%.

We find that the petitioner correctly echoed the conclusion of this Court in the aforementioned IBM case and which We reiterated in several similar cases thereafter. However, it is important to point out that the imposition of the 10% tax rate on royalties remitted to a resident of the USA is not without its conditions in the light of the two provisions found in the RP-US Tax Treaty in relation to the RP-West Germany Tax Treaty.

Article 13(2)(b)(iii) of the RP-US Tax Treaty provides the following, thus:

> **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 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) <u>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.</u> (Underscoring supplied)

The above provision which speaks of the "lowest rate of Philippine tax that may be imposed on royalties of the same kind paid under similar circumstance to a resident of a third state" points to a provision in the RP-West Germany Tax Treaty which imposes a mere 10% tax rate on royalties, thus:

> **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 law of that State, but the tax so charged shall not exceed:
>
> (a) 15 percent 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 percent 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.

The correlation between these aforecited tax treaties which led to the Court's conclusion of a 10% tax rate was placed in focus in the IBM case, thus:

> 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 RP-West Germany Tax Treaty and not 25% withholding tax on royalties under Article 13(2)(b)(iii) of the RP-US 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 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.

A perusal of the pertinent provisions in the R.P.-U.S. Tax Treaty and the R.P.-West Germany Tax Treaty reveals that the 10% tax rate shall be imposed only if the royalties remitted to a resident of the US are of the same nature as that given to a resident of West Germany, pursuant to Article 13(2)(b)(iii) of the US Tax Treaty which used the term "paid under similar circumstances". The phrase "under similar circumstances" which serves as one of the conditions for the imposition of the tax rate of 10% refers to royalties, as discussed in this Court's Resolution in the IBM case, CTA case No. 4308 dated July 21, 1993 denying respondent's Motion for Reconsideration, thus:

> 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 RP-US tax treaty. Article 13(2)(b)(iii) speaks of 'royalties of the same kind 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 RP-US 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 US 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 by 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, C.T.A. Records, pp. 363-364)

Viewed in this light, We find petitioner's allegations in its petition too simplistic and insufficient to warrant a similar application of the IBM decision to its present case. The instant petition for review contains no information as to the nature of the contract which gave rise to the royalties remitted to Macwhyte Company, a Corporation based in the US. As earlier discussed, it is necessary that the royalties paid to the US must originate from the use of, or the right to use any patent, trademark, design or model, plan, secret formula or process, or from the use, or the right to use, industrial, commercial or scientific experience, pursuant to that which is contained in the two treaties mentioned, in fulfillment of the condition embodied in the phrase "paid under similar circumstances". Moreover, petitioner did not present any evidence to show whether the contract from where the royalties arose, was duly approved by Philippine competent authorities again as prescribed by the RP-West Germany Tax Treaty (supra) which is likewise in fulfillment of the condition imposed by the two tax treaties. Tax refunds are in the nature of tax exemptions. As such, they are regarded as in derogation of sovereign authority and to be construed *stictissimi juris* against the person or entity claiming the exemption (**Commissioner of Internal Revenue vs. Procter and Gamble Philippine Manufacturing Corporation,** 204 SCRA 377). In the case entitled **Spouses Emmanuel Aguilar and Zenaida Aguilar vs. Commissioner of Internal Revenue and CTA;** CA-G.R. SP No. 16432; March 30, 1990, the Court of Appeals enunciated this principle clearly when it declared, thus:

> Verily, a claim for refund partakes of the nature of an exemption which cannot be allowed unless granted in the most explicit and categorical language. Being in the nature of an exemption from taxation, <u>a claim for refund is strictly construed against the claimant and his failure to sustain said burden is fatal to his claim.</u> (Underscoring supplied)

WHEREFORE, the claim for refund of petitioner in the amount of P156,909.00 is hereby **DENIED** for lack of merit.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

MANUEL K. GRUBA
Associate Judge

RAMON O. DE VEYRA
Associate Judge

CERTIFICATION

I hereby certify that this decision was reached after due consultation among 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