/13

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

BASF COATINGS AND INKS
PHILIPPINES, INC.,
Petitioner,

- versus -

CTA CASE NO. 5135

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

Promulgated:
OCT 01 1996

x - x

DECISION

This case involves a claim for refund in the sum of P167,918.65 as overpaid withholding tax on royalty payments to BASF Corporation, Delaware, U.S.A. (BASF-U.S.A. for brevity) corresponding to the period from July 1, 1992 to March 31, 1993.

Petitioner, BASF Coatings and Inks Phils., Inc. (BCIP for short) is a domestic registered corporation engaged in the manufacture of printing inks and auxiliaries for the graphics and packaging industries, with business address at 101 Marcos Alvarez Avenue, Bo. Talon, Las Pinas, Metro Manila.

Its predecessor, Ault and Wiborg, Phil. Branch, entered into a Graphics License Agreement (Exh. "C", Pet.; pp. 72-91, CTA rec.) with BASF - U.S.A., on October

26, 1988 whereby the latter granted to the former the right to use the know-how for the manufacture of printing inks and auxiliaries for the graphics and packaging industries. In return, Ault and Wiborg agreed to pay BASF - U.S.A. a two-percent (2%) royalty based on the net sales of the products it manufactured and sold or used.

The Graphics License Agreement between Ault and Wiborg and BASF - U.S.A. was registered with the Technology Transfer Board of the Bureau of Patents, Trademarks and Technology Transfer as evidenced by Certificate of Registration No. 953 dated August 1, 1989 (Exh. "D", Pet.; p. 92, CTA rec.).

On August 1, 1990, upon application with the Securities and Exchange Commission, Ault and Wiborg's license to engage in business in the Philippines was cancelled (Exh. "A", Pet.; p. 70, CTA rec.). On even date, the same government office approved the registration of the Articles of Incorporation of BCIP (Exh. "B", Pet.; p. 71, CTA rec.).

On November 13, 1990, the Technology Transfer Registry of the Bureau of Patents, Trademarks and Technology Transfer issued Certificate of Registration No. 0953-A (Exh. "E", Pet.; p. 93, CTA rec.) to reflect the due registration of the Graphics License Agreement between BASF - U.S.A. and petitioner BCIP.

For the period from July 1, 1992 to March 31, 1993, petitioner paid to BASF - U.S.A. royalties in the total amount of P1,119,457.45 and remitted to the B.I.R. P279,864.39 as 25% withholding tax thereon.

Believing that under the most favored nation clause of the RP - US Tax Treaty, the tax imposable on royalties should be only 10%, petitioner alleged that its tax remittance to the BIR was in excess by P167,918.65. Hence, on August 27, 1993, it filed with the Appellate Division of respondent a claim for refund or tax credit in the amount of P167,918.65.

As the two-year prescriptive period for the filing of a refund claim is about to expire, and respondent has not acted on the claim of petitioner, the latter filed the instant petition on August 2, 1994.

On September 6, 1994, respondent filed her Answer alleging the following as special and affirmative defenses, to wit:

> "6. The herein withholding tax on royalties is presumed to have been paid and collected in accordance with law and existing BIR Regulations on the matter;
>
> 7. Article 24 (b), (dd) and (c)(cc) of the RP-West Germany Tax Treaty allows a matching tax credit of 20% to Germans receiving royalties arising in the Philippines, whereas, Article 13, 2(b)(iii) of the RP - US Tax Treaty does not so provide. Hence, a resident of the United States is <u>not entitled</u> to the "most favored nation" tax rate of 10% on royalty

income derived from the Philippines for the simple reason that the payment of such tax is not under similar circumstances as the matching credit of 20% for royalties being granted under the RP - West Germany Tax Treaty;

8. Rulings previously issued by the respondent allowing the availment of the benefits of the "most favored nation" clause on payments of royalties to recipients/resident of the United States have already been revoked effective January 21, 1992 pursuant to Revenue Memorandum Circular No. 39-92;

9. The petition states no cause of action, there being no allegation as to the various dates the alleged withholding tax payments on royalties were made and/or effected by the petitioner;

10. The alleged withholding tax payments on royalties covering the period July 1, 1992 to August 1, 1992 are no longer refundable, the same being already barred by latches;

11. Claims for tax refund/credit being in the nature of exception from are construed strictly against the claimant/petitioner; (Insular Lumber Co. vs. Court of Tax Appeals, et al., 104 SCRA 710; Manila Electric Co. vs. Commissioner of Internal Revenue, October 22, 1975, 67 SCRA 310).

The two issues to be adjudicated in this case are:

1. Whether or not petitioner is entitled to the lower tax rate of 10% under the "most favored nation" clause of the RP - U.S. Tax Treaty; and

2. Whether or not the withholding tax payments covering the period from July 1, 1992 to August 1, 1993 have already prescribed.

Anent the first issue, this Court once again rules in favor of petitioner. The legal arguments raised by respondent in her special and affirmative defenses had already been settled by this Court in the case of "**IBM Philippines, Inc. vs. Commissioner of Internal Revenue," CTA Case No. 4306, decided on March 31, 1993,** where it was ruled that:

> "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, (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 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.

> 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 R.P. - US Tax Treaty."

Respondent's allegation 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 the payment of tax on royalties is not "under similar circumstances," had likewise been resolved by this Court in a Resolution, dated July 21, 1993 and promulgated under the aforementioned CTA Case No. 4308. In said Resolution, this Court resolved that:

> 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), there is no such tax credit 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. - Germany 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 percent according to paragraph 2 of Article 12, 20 percent 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 '<u>royalties</u> of the same kind paid under similar circumstances to a resident of third state'. Nowhere does it speak, whether express or implied, of <u>tax</u> 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 <u>royalty</u>, 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 <u>not</u> reference to the payment of tax." (Opposition, C.T.A. Records, pp. 363-364).

In a most recent case decided by this Court on April 23, 1996, it was emphasized that there are two important requirements that should be present/or complied with before the 10% rate of withholding tax on royalties remitted to a U.S. resident maybe availed of. These are:

> 1. It is necessary that there be an agreement or a contract whereby the royalties paid to the U.S. 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; and
>
> 2. The contract or agreement must be duly approved by Philippine competent authorities. (see p. 13, <u>Decision</u> in CTA Case No. 5141, "Jardine Davies, Inc. and Macwhyte Company, a Division of Amsted Industries, Inc. vs. Commissioner of Internal Revenue," promulgated on April, 23, 1996.)

Petitioner has complied with the above-mentioned requirements. It offered in evidence the Graphic License Agreement executed by and between Ault and Wiborg, petitioner's predecessor, and BASF - USA (Exh. "C") as well as the Certificate of Registration of such agreement (Exhs. "D" and "E") duly issued by the Technology Transfer Registry of the Bureau of Patents, Trademarks and Technology Transfer.

The actual remittance to the BIR of the amount being claimed as refundable/tax creditable was also proven by petitioner when it presented the Monthly Remittance Returns of Income Taxes Withheld (BIR Form 1743 W) for the subject period. They were marked and offered as Exhibits "I", "I-1", "J" to "Q", inclusive, found on pages 97 to 106 of the CTA records. Payments made through the bank are clearly reflected by the machine validations appearing at the bottom portions of said returns or exhibits.

As stated under paragraph 10 of respondent's Answer (p. 40, CTA rec.) and likewise under second issue of her Memorandum (p. 153, CTA rec.), the withholding tax payments on royalties covering the period July 1, 1992 to August 1, 1992 are no longer refundable. They are already barred by laches, inasmuch as the instant petition was filed only on August 2, 1994, or a day beyond the two-year period provided for by law.

The Court begs to disagree. Payments of withholding taxes on royalties for the period July 1, 1992 to August 1, 1992 did not prescribe. Respondent erroneously reckoned the two-year prescriptive period from the dates of payment of the royalties. Section 230 of the Tax Code clearly provides that the two-year period should be counted from the date of payment of the tax, not from the payment of royalties. Considering therefore, that the withholding tax on royalties for the month of July, 1992 was paid on August 10, 1992 and September 20, 1992 (see machine validations of bank, bottom parts of Exhs. "I" and "I-1" of petitioner; pp. 97 and 98, CTA rec.), and the withholding tax on royalties for August, 1992 was paid on September 9, 1992 (see also machine validations of bank, bottom parts of Exh. "J", Pet.; p. 99, CTA rec.), the filing of instant petition on August 2, 1994 was well within the two-year period prescribed by Section 230 of the Tax Code.

The presentation of the aforementioned exhibits together with the Statements of Royalties Payable to BASF Corporation (Exhs. "A" to "T", inclusive of sub-markings) properly identified by Ms. Josefa Estepa, petitioner's witness, strengthened all the more petitioner's entitlement to the refund/tax credit being claimed. Respondent did not only fail to comment on petitioner's offer of evidence, but she likewise failed to present any evidence to controvert petitioner's claim.

WHEREFORE, finding instant petition meritorious the Court **GRANTS** the same, and hereby **ORDERS** respondent to **REFUND/ISSUE A TAX CREDIT CERTIFICATE** in favor of petitioner in the amount of One Hundred Sixty Seven Thousand Nine Hundred Eighteen Pesos and Sixty-Five Centavos (P167,918.65) as overpaid withholding tax on royalty payments for the period from July 1, 1992 to March 31, 1993.

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