REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

CARGILL PHILIPPINES, INC.
Petitioner,

CTA EB No. 734
(CTA Case No. 7656)

Members:

-versus-

Acosta, *P.J.,*
Castañeda, Jr.,
Bautista,
Uy,
Casanova,
Palanca-Enriquez,
Fabon-Victorino,
Mindaro-Grulla, and
Cotangco-Manalastas, *JJ.*

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
MAY 2 4 2012 cwApolinario 2:00 p.m.

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DECISION

CASTAÑEDA, JR., J.:

For review are the Decision dated September 6, 2010 denying Cargill Philippines, Inc.'s Amended Petition for Review due to insufficiency of evidence and the Resolution dated February 15, 2011 also denying its Motion for Reconsideration for lack of merit, both issued by the Court's First Division in CTA Case No. 7656.

The assailed Court in Division's Decision dated September 6, 2010 and Resolution dated February 15, 2011 in effect denies the claimant's prayer for refund or the issuance of the tax credit certificate in the amount of P8,771,270.71 representing erroneously paid withholding taxes on royalties for the period of June 1, 2005 to April 30, 2007.

THE FACTS

Cargill Philippines, Inc. ("petitioner") is a corporation duly organized and existing under the laws of the Republic of the Philippines.[1] It is a VAT registered entity.[2]

The Commissioner of Internal Revenue ("respondent") as a public official is tasked to decide disputed assessments, collection, refund of erroneously or excessively paid internal revenue taxes, fees or other charges, penalties, or other matters under the 1997 National Internal Revenue Code ("NIRC"), as amended, or other laws administered by the Bureau of Internal Revenue ("BIR").

CAN Technologies, Inc. ("CAN") formerly known as AGX Services, Inc. ("AGX"), is a corporation duly organized and existing under the laws of the United States of America ("US").[3]

Effective June 1, 2002, pursuant to the Intellectual Property License Agreement executed by petitioner and CAN Technologies, they stipulated the following:

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[1] Docket, CTA Case No. 7656, p.363.
[2] Docket, CTA Case No. 7656, p.153.
[3] Docket, CTA Case No. 7656, p.364.

a) CAN shall grant petitioner a non-exclusive, royalty-bearing, and non-transferable license to use its patents, technology, and copyrights in the Philippines; and

b) in consideration for the intellectual property license, petitioner shall pay royalty fee equal to one and one-quarter percent (1.25%) of its Net Sales and five and one-quarter percent (5.25%) of its consulting revenues which result directly or indirectly from the use of the technology, patents and copyrights provided by CAN.[4]

In a letter dated December 14, 2005, petitioner inquired from the BIR if the royalty payments to CAN arising from the patents, technology and copyrights are subject to the preferential tax rate of ten (10%) percent of the gross amount of royalties in accordance with the most favored nation clause of the RP-US Tax Treaty, in relation to the RP-Bahrain Tax Treaty.

In reply, Assistant Commissioner for Legal Service, James H. Roldan issued BIR Ruling No. DA-ITAD 60-07 on May 11, 2007 granting the "most favored nation" tax rate of 10% of the gross amount of royalties based on the RP-Czech Tax Treaty covering the period beginning January 1, 2004.[5]

On July 10, 2007, petitioner filed with the BIR Large Taxpayers Service Audit and Investigation Division I, a written claim for refund or issuance of tax credit certificate representing overpayment of final tax erroneously withheld and remitted to the BIR for the period June 2005 to April 2007 under Sections 204(C)

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[4] Exhibit "F".
[5] Exhibit "E"

and 229 of the 1997 NIRC, as amended. On even date, petitioner also sought recourse before the Court in Division.

On August 14, 2007, petitioner filed an Amended Petition for Review praying that the Court in Division refund or issue a tax credit certificate in favor of petitioner in the amount of P8,771,270.71 representing erroneously paid withholding taxes on royalties for the period June 1, 2005 to April 30, 2007.[6]

In ruling for the respondent, the Court's First Division ("Court in Division") issued a Decision dated September 6, 2010 denying the Amended Petition for Review.[7]

Dissatisfied, petitioner moved to reconsider the assailed Decision and to reopen the case for presentation of additional evidence; however, the Court in Division denied the same for lack of merit in the Resolution dated February 15, 2011.[8]

THE ISSUES

Unfazed, petitioner appealed before the Court *en banc* raising the following issues:

A.

WHETHER OR NOT THE ROYALTY PAYMENTS MADE BY THE PETITIONER TO CAN TECHNOLOGIES, INC. FOR THE PERIOD JUNE 1, 2005 TO APRIL 30, 2007 ARE SUBJECT TO 10% FINAL WITHHOLDING TAX ON ROYALTIES UNDER THE RP-US TAX TREATY IN RELATION WITH THE RP-CZECH TAX TREATY. ℊℯ

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[6] Docket, CTA Case No. 7656, pp. 152-166.
[7] Penned by Associate Justice Erlinda P. Uy and concurred in by Presiding Justice Ernesto D. Acosta and Associate Justice Esperanza R. Fabon-Victorino. Rollo, pp. 61-77.
[8] Rollo, pp. 79-88.

B.

WHETHER OR NOT THE PETITIONER ERRONEOUSLY PAID FINAL WITHHOLDING TAXES ON ROYALTIES PAID TO CAN TECHNOLOGIES, INC. FOR THE PERIOD JUNE 1, 2005 TO APRIL 30, 2007, AND WHETHER SUCH ERRONEOUSLY PAID FINAL WITHHOLDING TAXES ARE DULY SUBSTANTIATED BY PROPER DOCUMENTS.

C.

WHETHER OR NOT PETITIONER IS ENTITLED TO THE CLAIMED REFUND OF TAX CREDIT IN THE TOTAL AMOUNT OF P8,771,270.71, REPRESENTING ERRONEOUSLY PAID FINAL WITHHOLDING TAXES ON ROYALTIES PAID TO CAN TECHNOLOGIES, INC. FOR THE PERIOD JUNE 1, 2005 TO APRIL 30, 2007.[9]

On June 22, 2011, the Court *en banc* required the parties to submit their memoranda within a period of thirty (30) days after the respondent failed to file her Comment to the Petition.[10]

On August 3, 2011, petitioner filed its Memorandum.[11]

In the Resolution dated September 14, 2011, the Court *en banc* noted that respondent is adopting all her arguments and affirmative defenses in the Answer filed on September 7, 2007; Opposition filed on November 2, 2010; and the findings of the Court in Division as her Memorandum.

THE COURT'S RULING

It is imperative for this Court to resolve if petitioner as a withholding agent is a proper party to the instant case.

PETITIONER AS THE WITHHOLDING AGENT IS A PROPER PARTY TO THE REFUND CLAIM. Je

[9] Rollo, p. 13.
[10] Rollo, p. 96.
[11] Rollo, p. 100.

Petitioner asserts that as a withholding agent, it has legal interest to file a claim for refund or the issuance of tax credit certificate for overpaid or erroneous taxes withheld to the government.

The Court agrees.

The taxpayer is the proper party to file a refund claim, and should the taxpayer opt not to file, the withholding agent may file a refund claim. In the case of *Commissioner of Internal Revenue v. SMART Communication, Inc.*[12], *the* Supreme Court explained why the withholding agent may file a refund claim as follows:

> Although such relation between the taxpayer and the withholding agent is a factor that increases the latter's legal interest to file a claim for refund, there is nothing in the decision to suggest that such relationship is required or that the lack of such relation deprives the withholding agent of the right to file a claim for refund. Rather, what is clear in the decision is that a withholding agent has a legal right to file a claim for refund for two reasons. ***First*, he is considered a "taxpayer" under the NIRC as he is personally liable for the withholding tax as well as for deficiency assessments, surcharges, and penalties, should the amount of the tax withheld be finally found to be less than the amount that should have been withheld under law. *Second*, as an agent of the taxpayer, his authority to file the necessary income tax return and to remit the tax withheld to the government impliedly includes the authority to file a claim for refund and to bring an action for recovery of such claim.** In this connection, it is however significant to add that while the withholding agent has the right to recover the taxes erroneously or illegally collected, he nevertheless has the obligation to remit the same to the principal taxpayer. **As an agent of the taxpayer, it is his duty to return what he has recovered; otherwise, he would be unjustly enriching himself at the expense of the principal taxpayer from whom the taxes were withheld, and from whom he derives his legal right to file a claim for refund.** (Emphasis supplied.)

Thus, petitioner as the withholding agent may file a refund claim before

[12] G.R. Nos. 179045-46, August 25, 2010, 629 SCRA 342.

this Court on the basis of the alleged overpayment of taxes withheld on royalty payments to CAN.

We shall now proceed to the merits of the case.

THE CIRCUMSTANCES OF RESIDENTS AND CITIZENS OF THE UNITED STATES ARE DISSIMILAR TO THE CIRCUMSTANCES OF RESIDENTS OF THE CZECH REPUBLIC IN SO FAR AS THE TAX PAYMENTS ON ROYALTIES DERIVED FROM SOURCES WITHIN THE PHILIPPINES UNDER THE PROVISIONS OF THE RP-US AND RP-CZECH TAX TREATIES.

THE MOST FAVORED NATION TAX RATE OF TEN (10%) PERCENT ON ROYALTIES PAID TO CAN IS INAPPLICABLE TO THE INSTANT CASE.

According to petitioner, evidence show that CAN is a US corporation. In view of the existence of a tax treaty between the Philippines and the US, the income tax on the royalty fees paid by petitioner to CAN shall be governed by the RP-US Tax Treaty. Petitioner's refund claim based on the erroneous withholding of taxes paid on the royalties due to CAN, fall within the scope of Article 13(2)(b)(iii) of the RP-US Tax Treaty in relation to Article 12(2)(a) of the RP-Czech Tax Treaty.

Section 901 (b)(1) of the US Internal Revenue Code mirrors the tax treaty provision where a resident of the US is allowed a tax credit on the amount of taxes paid or accrued to any foreign country, such as the Philippines. Section 904(a) of the same Code provides for the limitation as to what can actually be credited. This limitation provides the amount of the credit taken shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources without the United States bears to his taxable income for the same taxable year. It simply means that the tax credit should not exceed the US tax apportioned to such income from foreign source.

The US law on royalties derived from sources within the Philippines is the same as the limitations to a resident of the Czech Republic. While the RP-Czech Tax Treaty mentions that the tax credit on income sourced from the Philippines shall be limited to the Czech tax appropriate to such income, the US tax law likewise limits the tax credit to the US tax apportioned to such foreign-sourced income.

Petitioner submits that the doctrine of processual presumption applied by the Court in Division would clearly demonstrate that the taxes paid in the Philippines under RP-US Tax Treaty are paid under circumstances as that of the taxes paid on royalties under the RP-Czech Tax Treaty.

Petitioner alleges that the Court in Division erroneously ruled that foreign taxes may not be automatically credited against the income tax due of the subject taxpayer, unless he is able to show that he has signified in the tax return his option to claim the foreign tax payment as tax credit instead of tax deduction.

In the case at bar, the reference provision in so far as the entitlement to the 10% tax on royalty payments to a resident of the United States concerned is the provision of the RP-Czech Tax Treaty. Under this treaty, a Czech resident is allowed to claim as deduction from the amount of tax computed on such a base an amount equal to the tax paid in the Philippines, subject to the limitation that the tax deduction shall not exceed the tax due on such income imposed by the Czech Republic. This does not mandatorily impose upon, the taxpayer to claim the taxes paid in the Philippines as a deduction against the tax due in the Czech Republic.

On the other hand, under the US law which is presumed to be the same as the Philippine law under the principle of processual presumption as applied by the Court in Division, the taxpayer is allowed to claim as tax credit the taxes paid in the Philippines against the income tax due in the US, provided it should not also exceed the taxes due on such income imposed by the United States. The fact that the taxpayer actually availed of the tax credit is of no moment. What is significant is that he is allowed to do so.

The taxes on royalties under both the RP-US Tax Treaty and the RP-Czech Tax Treaty are paid under similar circumstances, considering that the taxes paid on such royalties in the Philippines are allowed as tax credit from the tax due on such income imposed in the United States, and on the taxes due on such income imposed in the Czech Republic. Likewise, the tax credits allowed by both countries are limited to the taxes imposed by the respective countries on such income.

Petitioner further argues that reference to the US law is not even a requirement for the application of Article 13(2)(b)(iii) of the RP-US Tax Treaty, also known as the most favored nation clause, in relation to Article 12(2)(a) of the RP-Czech Tax Treaty. The *SC Johnson case* did not also consider this as a factor in determining whether or not the provision is complied with in relation to the RP-West Germany Tax Treaty. As the present case involves the same application of the most favored nation clause of the RP-US Tax Treaty, a referral to the US law is irrelevant in determining whether or not the most favored nation clause of the RP-US Tax Treaty is complied with in relation to the RP-Czech Tax Treaty.

The tax treaties executed by the Philippines with the US, West Germany and Czech Republic allow the amount of taxes paid in the Philippines as tax credit/deduction against the income tax due in the home countries. In the case of the United States, the amount that is allowed as credit/deduction is the amount of tax that is paid or accrued to the Philippines. In other words, the US resident may claim the amount of taxes paid in the Philippines as tax credit against its income tax due in the United States on the royalty income earned from sources within the Philippines and against which the Philippine income tax was paid or accrued. That amount that may be credited is only the actual amount of taxes paid in the Philippines. The same rule holds true in the case of Czech Republic.

In the *SC Johnson case*, it is the presence of the matching credit in the RP-Germany Tax Treaty, and its absence in the RP-US Tax Treaty that distinguishes the taxes paid on royalties under the RP-US and RP-Germany Tax Treaties.

Moreover, in the *SC Johnson case*, the Supreme Court did not go to the extent of differentiating the domestic laws of the United States and the domestic laws of Germany. The Supreme Court did not consider the domestic laws of these foreign countries as relevant in the determination of whether or not the taxes paid in the Philippines are paid under similar circumstances. This must be so because the phrase "paid under similar circumstances" refers to the payments of taxes in the Philippines under the tax treaties, and not to the payments of taxes in the home country based on the domestic law.

And since the subject royalties involved refer to the royalties in the Philippines, the taxes on royalties referred to here pertains to the taxes paid in the Philippines based on the treaties and not the taxes paid in the country where the recipient of the royalty income is a resident.

Domestic laws of one contracting state are beyond the powers of negotiation by the other contracting state. The fact that it is mentioned in the tax treaties that the amount actually credited shall be subject to the provisions of the domestic law of the contracting state is merely a recognition or acknowledgment by the contracting states of the existence of a domestic law that may ultimately govern the disposition of foreign tax credits on foreign sourced income.

Respondent on the other hand counters that since petitioner failed to comply with the requirements of the most favored nation clause, it is not entitled to the concessional tax rate of 10% on royalty payments to CAN.

Petitioner's contentions are unmeritorious.

We shall ascertain if the lower tax rate of 10% applies to the royalty payments to CAN pursuant to the doctrine of the most favored nation clause.

From years 1966 to 1992[13], the Philippines has concluded several tax treaties with nations aimed to prevent situation of double taxation by reducing the tax rate in a manner our country will give up a part of the tax in the expectation that the tax given up for this particular investment is not taxed by the other country.[14] *gc*

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[13] Prof. Eustaquio O. Ordoño, 1998 Edition, Philippine Tax Treaties, 1998 Edition, p. xii.
[14] See *Commissioner of Internal Revenue v. S.C. Johnson and Son,* Inc., G.R. No. 127105, June 25, 1999, 309 SCRA 87.

The exemption method and the credit method are two methods of relief from double taxation described in the landmark case of *Commissioner of Internal Revenue v. S.C. Johnson and Johnson*[15] as follows:

> There are two methods of relief- **the exemption method and the credit method.** In the exemption method, the income or capital which is taxable in the state of source or situs is exempted in the state of residence, although in some instances it may be taken into account in determining the rate of tax applicable to the taxpayer's remaining income or capital. On the other hand, **in the credit method, although the income or capital which is taxed in the state of source is still taxable in the state of residence, the tax paid in the former is credited against the tax levied in the latter.** The basic difference between the two methods is that in the exemption method, the focus is on the income or capital itself, whereas the credit method focuses upon the tax. (Emphasis supplied.)

In the *S.C Johnson* case, S.C. Johnson Philippines withheld royalty payments to S.C. Johnson US for the use of trademark, patents and technology under the tax rate of 25% covering the period of July 1992 to May 1993. S.C. Johnson Philippines filed for an administrative refund claim with the Commissioner through the BIR- International Tax Affairs Division ("ITAD") due to overpayment of royalty taxes withheld. It argued that it may apply for the most favored nation clause tax rate under the RP-US and RP-Germany Tax Treaties. The Commissioner did not act on its refund claim. On appeal, the Court of Tax Appeals and the Court of Appeals allowed the refund claim of the overpaid withholding taxes on royalty payments based on the preferential tax rate of 10% pursuant to the most favored nation clause of the RP-US and RP-West Germany Tax Treaties. The Supreme Court reversed and set-aside the Court of Appeals decision and concluded that RP-US Tax Treaty does not give a matching credit of

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15 *Commissioner of Internal Revenue v. S.C. Johnson and Son, Inc., supra.*

20% for the taxes paid to the Philippines on royalties as allowed under the RP-West Germany Tax Treaty. Thus, S.C. Johnson Philippines is disqualified to claim for the lower 10% tax rate because there is no payment of taxes on royalties under similar circumstances.

The Supreme Court further explained in the *S.C. Johnson*[16] case that the avoidance of double taxation should be construed in the light of the most favored nation clause synthesized as follows:

> **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% for royalties) would derogate from the design behind the most favored nation clause to grant equality of international treatment since the tax burden laid 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.** (Emphasis supplied.)

Also emphasized in the *S.C. Johnson case* are the requisites of the most favored nation clause, namely: 1) similarity of the subject matter of taxation; and the similarity in the circumstances of the payment of taxes.[17]

In the instant case, CAN is a non-resident foreign corporation based in the United States. It receives royalty payments in the Philippines as remuneration for the use of patents, technology and copyrights by petitioner, a domestic

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[16] *Commissioner of Internal Revenue v. S.C. Johnson and Son, Inc., supra.*
Commissioner of Internal Revenue v. S.C. Johnson and Son, Inc., supra.
[17] *Commissioner of Internal Revenue v. S.C. Johnson and Son, Inc., supra.*

corporation. Clearly, the source of income in the form of royalty payments is in the Philippines.

Under Philippine law, specifically Section 28(B)(1) of the 1997 NIRC, as amended, the 35% income tax rate is imposed on non-resident foreign corporations receiving royalties within the Philippines. Pursuant to the most-favored nation clause echoed in the *S.C. Johnson* case, a lower tax rate on royalty payments enforced in a third state (West Germany) may be availed provided that the income or capital taxable in the state of source of royalty payments (Philippines) is credited in the state of residence (US—domicile of SC Johnson US) and the tax reliefs on royalty payments granted by the applicable tax treaties are the same.

Here, the Czech Republic and the Philippines inked a bilateral tax treaty agreement ("RP-Czech Tax Treaty") which provides a lower 10% tax rate on royalty payments for the use of patents, trade mark, design or model, plan, secret formula or process, or from the use or the right to use industrial, commercial or scientific equipment or information. CAN, a U.S. based corporation is the entity primarily liable for income taxes for royalty payments withheld by petitioner.

Comparing Article 13(2)(b)(iii) of the RP-US Tax Treaty, in relation to Article 12(2)(a) of the RP-Czech Tax Treaty, it is not disputed that both provisions pertain to taxation on royalty payments. **Thus, the first requisite of the most favored nation clause is present**.

Proceeding to the second requisite mentioned in the *S.C. Johnson case*, before petitioner as a withholding agent may invoke the most favored nation tax rate on royalty payments to CAN, petitioner has the burden of proof to show that the RP-Czech and RP-US Tax Treaties grant similar tax reliefs on royalty payments.

The pertinent provisions of the two tax treaties state:

RP-CZECH TAX TREATY	**RP-US 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 beneficial owner of the royalties is a resident of the other contracting state, the tax so charged shall not exceed: **a)10 per cent of the gross amount of the royalties** arising from the use of, or the right to use, any copy right of literary, artistic or scientific work, other than that mentioned in subparagraph **(b), 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;** b) 15 per cent of the gross amount of the royalties arising from the use of, or	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**

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the right to use, any copyright of cinematograph films, and films or tapes for television or radio broadcasting.	**same kind paid under similar circumstances to a resident of a third state. (Emphasis supplied.)**
Article 22 ELIMINATION OF DOUBLE TAXATION xxx xxx xxx 2. In the case of a resident of the Czech Republic, double taxation shall be eliminated as follows: a) The Czech Republic, when imposing taxes on its residents, may include in the tax base upon which such taxes are imposed the items of income which according to the provisions of this Convention may also be taxed in the Philippines, **but shall allow as a deduction from the amount of tax computed on such a base an amount equal to the tax paid in the Philippines. Such deduction shall not, however, exceed that part of the Czech tax, as computed before the deduction is given, which is appropriate to the income which, in accordance with the provisions of this Convention, may be taxed in the Philippines.**	**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**

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	limitations (for the purpose of 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. (Emphasis supplied.)

Article 12 of the RP-Czech Tax Treaty affords 10% tax rate on the gross amount of royalties arising from the use of 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.

Under Article 13 of the RP-US Tax Treaty, the Philippines may impose one of three rates — 25 percent of the gross amount of the royalties; 15 percent when the royalties are paid by a corporation registered with the Philippine Board of Investments 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 a third state.[18]

In Article 22 of the RP-Czech Tax Treaty, the Czech Republic allows "deduction from the amount of the tax computed on such a base an amount equal to the tax paid in the Philippines". While the term deduction is mentioned in Article 22 of the RP-Czech Tax Treaty, this should be treated to mean as a tax credit because there is a reduction of the tax due.[19] A Czech resident's tax due

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[18] *Commissioner of Internal Revenue v. S.C. Johnson and Son, Inc., supra.*
[19] *Commissioner of Internal Revenue v. Central Luzon Drug Corporation*, G.R. No. 159647, April 15, 2005, 456 SCRA 414.

may be reduced or credited should it pay taxes in the Philippines. Likewise, in Article 23 of the RP-US Tax Treaty, the U.S. allows its citizens or residents a tax credit on the paid or accrued taxes in the Philippines.

While both treaties recognize the tax credit method, the disparity lies on the entity subject to Philippine tax on royalty to be credited in the other country. In the RP-Czech Tax Treaty, the Czech Republic allows a **resident** to credit tax on royalty paid in the Philippines; while the scope of RP-US Tax Treaty as to the tax credit covers both **residents and citizens** of the U.S.

Another difference is when the tax credit shall be recognized. In the RP-Czech Tax Treaty, the Czech Republic allows tax credit on taxes on royalties ***paid*** in the Philippines; however, in the RP-US Tax Treaty, the U.S. recognizes tax credit on taxes on royalties ***paid or accrued*** in the Philippines.

The RP-US Tax Treaty on the other hand, further imposes **reference to the U.S. law on the amount of tax to be credited**. This condition cannot be found in the RP-Czech Tax Treaty. The Court in Division correctly pointed that:

> A cursory reading of the foregoing provisions would reveal that while both provide the credit method as a means of eliminating international juridical double taxation , We cannot say for certain whether the limitation of the amount that may be credited under the RP-US Tax Treaty would be similar to that stated under the RP-Czech Tax Treaty. Under the RP-US Tax Treaty, reference still has to be made to the *"United States law"* to determine the said limitation, while under the RP-Czech Tax Treaty, it is no longer necessary, since it is already specific, *i.e.,* the deduction (or tax credit) shall not exceed the part of the Czech tax which is appropriate to the income earned.
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> Records show that petitioner failed to present evidence to prove or establish the provisions of the United States law which would determine the limitation being referred to in Article 23(1) of the RP-US Tax Treaty. Thus, We cannot say for certain that the RP-US Tax Treaty grants similar tax reliefs to residents of the United States with respect to taxes imposable upon

> royalties earned from sources within the Philippines as those allowed to Czech residents under the RP-Czech Tax Treaty.
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> The limitation of the amount that may be credited under the RP-US Tax Treaty must be clearly established. This must be so because 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.[20]

Tax refunds are construed strictly against the taxpayer.[21] As the claimant acting on behalf of CAN, petitioner failed to show similarity in the circumstances in the payment of taxes on royalties under the RP-Czech and RP-US Tax Treaties. Evidently, the second requirement of the most favored nation clause is wanting.

Also, in the *S.C. Johnson* case[22], the Supreme Court expounded on the rationale why the provisions of the tax treaties must contain similarity on tax reliefs as a condition for the claimant to apply a lower tax rate under the most favored nation clause. In the words of the Honorable High Court:

> Given the purpose underlying tax treaties and the rationale for the most favored nation clause, the concessional tax rate of 10% provided for in the RP-Germany Tax Treaty should apply only if the taxes imposed upon royalties in the RP-US Tax Treaty and in the RP-Germany Tax Treaty are *paid under similar circumstances.* This would mean that private respondent must prove that the RP-US Tax Treaty grants similar tax reliefs to residents of the United States in respect of the taxes imposable upon royalties earned from sources within the Philippines as those allowed to their German counterparts under the RP-Germany Tax Treaty.
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> **The RP-US and the RP-Germany Tax Treaties do not contain similar provisions on tax crediting. Article 24 of the RP-Germany Tax Treaty, expressly allows crediting against German**

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[20] Rollo, p. 75.
[21] *Far East Bank and Trust Company v. Court of Appeals*, G.R No. 129130, December 09, 2005, 477 SCRA 49. See *Paseo Realty & Development Corporation v. Court of Appeals,* G.R. No. 119286, October 13, 2004, 440 SCRA 235.
[22] *Commissioner of Internal Revenue v. S.C. Johnson and Son, Inc., supra.*

> **income and corporation tax of 20% of the gross amount of royalties paid under the law of the Philippines. On the other hand, Article 23 of the RP-US Tax Treaty which is the counterpart provision with respect to relief for double taxation, does not provide for similar crediting of 20% of the gross amount of royalties paid.** (Emphasis supplied.)
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> xxx xxx xxx
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> The reason for construing the phrase "paid under similar circumstances" as used in Article 13(2)(b)(iii) of the RP-US Tax Treaty as referring to taxes is anchored upon a logical reading of the text in the light of the fundamental purpose of such treaty which is to grant an incentive to the foreign investor by lowering the tax and at the same time crediting against the domestic tax abroad a figure higher than what was collected in the Philippines.

BIR RULING NO. DA-ITAD 60-07 IS NOT BINDING UPON THE PARTIES.

In BIR Ruling DA-ITAD 060-07 dated May 11, 2007, Assistant Commissioner James H. Roldan ruled that petitioner is entitled to the benefits of the most-favored nation clause under the RP-US and RP-Czech Tax Treaties. He further declared that applying the RP-Czech Tax Treaty, the royalty fees paid by petitioner to CAN for the use or the right to use the patents, technology and copyrights are subject to 10% based on the gross amount, provided that the two conditions for the most favored nation tax treatment of royalties pursuant to the SC Johnson case are satisfied.

Through the confirmatory ruling issued by the BIR showing petitioner's compliance with the two conditions, the royalty fees paid by petitioner to CAN from June 1, 2005 to April 30, 2007, are subject to the preferential tax rate of 10% based on the gross amount.

As the BIR Ruling explained the mechanism of the tax credit under the US law, petitioner insists that it had in fact supported its availment of the most favored nation clause of the RP-US Tax Treaty.

Respondent contends that petitioner failed to present evidence to establish the provisions of the US law which would determine the limitation being referred to in Article 23(1) of the RP-US Tax Treaty. It is uncertain that RP-US Tax Treaty grants similar tax reliefs to residents of the United States with respect to taxes imposable upon royalties earned from sources within the Philippines as those allowed to Czech residents under the RP-Czech Tax Treaty.

We are not persuaded with petitioner's posture.

As earlier discussed, the *S.C. Johnson* case requires compliance with the most favored nation clause requirements, namely: similarity of the subject matter of taxation; and similarity in the circumstances in the payment of taxes necessary for the claimant to avail of the lower tax rate. In this case, petitioner failed to satisfy the second requisite.

Judicial decisions applying or interpreting the laws or the Constitution shall form part of the legal system of the Philippines. It enjoins adherence to judicial precedents. It requires our courts to follow a rule already established in a final decision of the Supreme Court. That decision becomes a judicial precedent to be followed in subsequent cases by all courts in the land.[23] Supreme Court decisions

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[23] *Amelia D. De Mesa, et al. v. Pepsi Cola Products Phils., Inc and Pepsico Inc.,* G.R. Nos. 153063-70. August 19, 2005, 467 SCRA 433 citing Article 8 of the Civil Code, 467 SCRA 433.

such as the ruling in the *S.C. Johnson* case assume the same authority as valid statutes.[24]

In a litany of cases, administrative rulings should be in consonance with the Constitution and law as synthesized in the case of *Commissioner of Internal Revenue v. Fortune Tobacco Corporation*[25] where the Supreme Court ruled that:

> This is not the first time that national revenue officials had ventured in the area of unauthorized administrative legislation.
>
> In *Commissioner of Internal Revenue v. Reyes*, respondent was not informed in writing of the law and the facts on which the assessment of estate taxes was made pursuant to Section 228 of the 1997 Tax Code, as amended by Republic Act (R.A.) No. 8424. She was merely notified of the findings by the Commissioner, who had simply relied upon the old provisions of the law and Revenue Regulation No. 12-85 which was based on the old provision of the law. **The Court held that in case of discrepancy between the law as amended and the implementing regulation based on the old law, the former necessarily prevails. The law must still be followed, even though the existing tax regulation at that time provided for a different procedure.**
>
> In *Commissioner of Internal Revenue v. Central Luzon Drug Corporation*, the tax authorities gave the term "tax credit" in Sections 2(i) and 4 of Revenue Regulation 2-94 a meaning utterly disparate from what R.A. No. 7432 provides. Their interpretation muddled up the intent of Congress to grant a mere discount privilege and not a sales discount. **The Court, striking down the revenue regulation, held that an administrative agency issuing regulations may not enlarge, alter or restrict the provisions of the law it administers, and it cannot engraft additional requirements not contemplated by the legislature. The Court emphasized that tax administrators are not allowed to expand or contract the legislative mandate and that the "plain meaning rule" or *verba legis* in statutory construction should be applied such that where the words of a statute are clear, plain and free from ambiguity, it must be given its literal meaning and applied without attempted interpretation.**

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[24] *See National Amnesty Commission v. Commission on Audit, et al.* G.R. No. 156982, September 8, 2004, 437 SCRA 655.

[25] G.R. No. 167274-75, July 21, 2008, 559 SCRA 160 citing *Commissioner of Internal Revenue v. Reyes*, G.R. Nos. 159694 and 163581, January 27, 2006, 480 SCRA 382; *Commissioner of Internal Revenue v. Central Luzon Drug Corporation,* G.R. No. 159647, April 15, 2005, 456 SCRA 414; *Commissioner of Internal Revenue v. Michel J. Lhuillier Pawnshop, Inc.,* G.R. No. 150947, July 15, 2003, 406 SCRA 178 and *Commissioner of Internal Revenue v. CA, et al.*, G.R. No. 108358, January 20,1995, 240 SCRA 368.

As we have previously declared, rule-making power must be confined to details for regulating the mode or proceedings in order to carry into effect the law as it has been enacted, and it cannot be extended to amend or expand the statutory requirements or to embrace matters not covered by the statute. Administrative regulations must always be in harmony with the provisions of the law because any resulting discrepancy between the two will always be resolved in favor of the basic law.

In *Commissioner of Internal Revenue v. Michel J. Lhuillier Pawnshop, Inc.*, Commissioner Jose Ong issued Revenue Memorandum Order (RMO) No. 15-91, as well as the clarificatory Revenue Memorandum Circular (RMC) 43-91, imposing a 5% lending investor's tax under the 1977 Tax Code, as amended by Executive Order (E.O.) No. 273, on pawnshops. The Commissioner anchored the imposition on the definition of lending investors provided in the 1977 Tax Code which, according to him, was broad enough to include pawnshop operators. However, the Court noted that pawnshops and lending investors were subjected to different tax treatments under the Tax Code prior to its amendment by the executive order; that Congress never intended to treat pawnshops in the same way as lending investors; and that the particularly involved section of the Tax Code explicitly subjected lending investors and dealers in securities only to percentage tax. And so the Court affirmed the invalidity of the challenged circulars, stressing that "administrative issuances must not override, supplant or modify the law, but must remain consistent with the law they intend to carry out."

In *Philippine Bank of Communications v. Commissioner of Internal Revenue,* the then acting Commissioner issued RMC 7-85, changing the prescriptive period of two years to ten years for claims of excess quarterly income tax payments, thereby creating a clear inconsistency with the provision of Section 230 of the 1977 Tax Code. The Court nullified the circular, ruling that the BIR did not simply interpret the law; rather it legislated guidelines contrary to the statute passed by Congress. The Court held:

It bears repeating that Revenue memorandum-circulars are considered administrative rulings (in the sense of more specific and less general interpretations of tax laws) which are issued from time to time by the Commissioner of Internal Revenue. It is widely accepted that the interpretation placed upon a statute by the executive officers, whose duty is to enforce it, is entitled to great respect by the courts. Nevertheless, such interpretation is not conclusive and will be ignored if judicially found to be erroneous. Thus, courts will not countenance administrative issuances that override, instead of remaining consistent and in harmony with, the law they seek to apply and implement.

In *Commissioner of Internal Revenue v. CA, et al.*, the central issue was the validity of RMO 4-87 which had construed the amnesty

> coverage under E.O. No. 41 (1986) to include only assessments issued by the BIR after the promulgation of the executive order on 22 August 1986 and not assessments made to that date. Resolving the issue in the negative, the Court held:
>
> x x x all such issuances must not override, but must remain consistent and in harmony with, the law they seek to apply and implement. **Administrative rules and regulations are intended to carry out, neither to supplant nor to modify, the law.** (Emphasis supplied.)

We concur with the Court in Division in holding that BIR Ruling No. DA-ITAD 60-07 cannot be given weight. The Court in Division correctly observed that:

> A second hard look of the said Ruling would reveal again our previous finding that said Ruling merely cited Article 23 of the RP-US Tax Treaty and Article 22 of the RP-Czech Tax Treaty and immediately jumped to conclusion, without further explanation or elaboration, that the mechanism employed by the US in mitigating the effects of double taxation of income derived by its residents from foreign sources is the same with that employed by the Czech Republic.[26]

To recapitulate, petitioner may not avail of the lower 10% tax rate on income taxes withheld on royalty payments to CAN for its failure to comply with the requirements of the most favored nation clause embodied in the *S.C. Johnson* case. There being no erroneous withholding of income taxes on royalty payments for the period of June 1, 2005 to April 30, 2007, petitioner is not entitled to the refund claim in the amount of P8,771,270.71.

The Court sees no other reason to resolve the other issues for being moot. *Jl*

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[26] Rollo, p. 86.

WHEREFORE, premises considered, the Petition is **DISMISSED**. The Court in Division's Decision dated September 6, 2010 and the Resolution dated February 15, 2011 are hereby **AFFIRMED**.

SO ORDERED.

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

(On Wellness Leave)
LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

(On Wellness Leave)
CIELITO N. MINDARO-GRULLA
Associate Justice

AMELIA R. COTANGCO-MANALASTAS
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.

ERNESTO D. ACOSTA
Presiding Justice