LIB

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SYSTEMATICS, INC., (Currently ALLTEL FINANCIAL INFORMATION SERVICES, INC.),
Petitioner,

- versus -

C.T.A. CASE NO. 5212

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
SEP 30 1997

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DECISION

This is a claim for the refund of P1,475,172.68 representing alleged overpaid withholding taxes on royalties remitted to the petitioner by the Bank of the Philippine Islands (BPI) for the months of February and June, 1993.

Petitioner is a Philippine representative office of Systematics, Inc., a non-resident foreign corporation organized and existing under the laws of Arkansas, U.S.A. On April 30, 1989, Petitioner entered into a license agreement with the Bank of the Philippine Islands (BPI), a banking corporation organized and existing under the laws of the Philippines. This license agreement was called "Investment Charter Software License Agreement". Under such an agreement, petitioner granted BPI a non-exclusive license to use its software specified therein and in exchange, BPI agreed to pay royalties to the petitioner in an amount equal to 5% of the net amount it received from its service bureau customers. This license agreement entered into between petitioner and BPI was registered with the Technology Transfer Registry of the Bureau of Patents, Trademark and Technology Transfer (Exhibit "F").

Petitioner alleges that for the months of February and June, 1993, BPI withheld a final tax of 35% on the royalties it received as a consequence of the aforementioned agreement. The withholding taxes that were paid are detailed hereunder as follows:

Amount of Income Payment	Tax Rate	Amount of Tax Withheld
P 72,224.37	35%	P 25,278.53
4,085.17	35%	1,429.81
5,824,381.14	35%	2,038,533.40
P5,900,690.68		P2,065,241.74

On March 6, 1995, petitioner filed with the Bureau of Internal Revenue a claim for a tax credit/refund in the amount of P1,475,172.68 (Exhibit "G") declaring therein that BPI erroneously withheld a 35% final tax on its royalties. It further claimed that the correct amount of final withholding tax should only be 10% as enunciated by this Court in the case entitled **IBM Philippines, Inc. v. Commissioner of Internal Revenue, CTA Case No. 4308, dated March 31, 1993,** pursuant to

Article 13(2)(4)(b)(iii) of the RP-US Tax Treaty in relation to Article 12 of the RP-West Germany Tax Treaty, which grants a preferential rate of 10% on royalties derived by a resident of the U.S. from sources within the Philippines. Furthermore, BIR Ruling No. 79-91, dated May 3, 1991, categorically stated that all license fees and royalties arising in the Philippines and payable to petitioner are subject to a preferential 10% withholding tax under the aforementioned treaties (Exhibit "I").

Petitioner did not wait for the response of respondent, instead it immediately elevated this cause of action with this Court by the filing of a petition for review on March 10, 1995. The allegations contained in this petition merely mirrored those which were already proposed in the administrative level.

Respondent, on the other hand, expressed her objections to this claim for refund or tax credit by setting forth the following Special and Affirmative Defenses, thus:

> 4. The cited case of IBM Philippines vs. Commissioner of Internal Revenue (CTA Case No. 4308) relied upon by petitioner in its herein claim for tax refund is not applicable to the instant case;
>
> 5. The decision in the aforesaid CTA Case No. 4308 did not expressly declare RMC No. 39-92 as null and void and of no effect.

Neither did it revoke the same, hence, RMC No. 39-92 still stands valid and enforceable;

6. Beginning January 21, 1992, the tax liabilities which accrue or become payable as royalty payment shall be determined at the correct tax rate under the conditions provided for in RMC No. 39-92;

7. The "most favored nation" clause provision found in Article 13(2)(b)(iii) of the RP-US Tax Treaty which was invoked and made the basis of the decision in the IBM Corporation case can no longer be availed of in the instant case by reason of RMC No. 39-92 dated July 1, 1992 which provides that "rulings previously issued by the Bureau of Internal Revenue allowing availment of the benefit of the 'most favored nation clause' on payment of royalties to recipients in the United States are revoked effective January 21, 1992";

8. The situation on royalties of the contracting parties under the RP-US Tax Treaty is not similar to that under the RP-West Germany Tax Treaty for the reason that the matching credit of 20% for royalties arising in the Philippines allowed under the RP-West Germany Tax Treaty is not available under the RP-US Tax Treaty;

9. The taxes sought to be refunded in this case were collected in accordance with law and applicable BIR rulings and regulations;

10. Petitioner, who has the burden of proving that it is entitled to tax refund, has failed to establish that the tax subject of its claim for refund was erroneously or illegally collected.

The facts as presented lead Us to the following issues:

1. Whether or not the royalties received by herein petitioner should be taxed at the rate of 10% withholding tax in accordance with

Article 12(2) of the RP-West Germany Tax Treaty; and

2. Whether or not petitioner is entitled to a tax credit/refund of P1,475,172.68, representing alleged overpaid withholding tax on royalties it received from sources within the Philippines.

Petitioner anchors its legal claim on the decision promulgated by this Court in the case entitled **IBM Philippines v. Commissioner of Internal Revenue, CTA Case No. 4308,** dated **March 31, 1993**, which upheld the wisdom of the BIR Ruling No. 456-88, rendered by then Commissioner of Internal Revenue, Bienvenido Tan, Jr., where it was proclaimed that under the "most favored nation provision" of the RP-US Tax Treaty, the tax imposable on royalties derived by a resident of the United States from sources within the Philippines shall be 10% and not 35%.

Respondent contested the most favored nation provision relied upon by the petitioner and argued that in the light of the issuance of Revenue Memorandum, Circular No. 39-92, dated July 1, 1992, all the rulings issued by the Bureau of Internal Revenue recognizing the most favored nation provision are revoked effective January 21, 1992, thus the correct withholding tax rate is 35% and not 10% as claimed by herein petitioner.

This Court is all too familiar with the legal issue that presently confronts Us and in a long line of decisions including the much-quoted IBM case aforecited, We have remained resolute in upholding the declarations proclaimed by the former Commissioner, Bienvenido Tan, Jr., in BIR Ruling No. 456-88. A portion of the aforementioned IBM case is quoted hereunder, thus:

> "This Court is of the persuasion that petitioner's stand is correct and concurs with the opinion rendered by the 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."

We have reiterated the aforequoted ruling in disposing of similar and repetitive issues in the following cases:

1. Abbot Laboratories, (Philippines) v. Commissioner of Internal Revenue, CTA Case No. 5119, September 9, 1996;

2. S.C. Johnson and Sons, Inc. v. Commissioner of Internal Revenue, CTA Case No. 5136, May 7, 1996;

3. Armco Marsteel Alloy Corporation v. Commissioner of Internal Revenue, CTA Case No. 5115, February 6, 1996;

4. Gillete (Philippines), Inc. v. Commissioner of Internal Revenue, CTA Case No. 4248, February 8, 1995;

5. SmithKline and French Overseas Company v. Commissioner of Internal Revenue, CTA Case No. 5048, September 22, 1995;

6. General Electric Philippines Meter and Instrument Co., Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4158, December 5, 1991;

7. IBM Philippines, Inc. v. Commissioner of Internal Revenue, CTA Case No. 4308, March 3, 1993; and

8. Kimberly-Clark Corporation (USA) and Kimberly-Clark (Philippines) Inc. v. Commissioner of Internal Revenue, CTA Case No. 4288, January 30, 1992.

The conclusions that a 10% withholding tax rate shall be imposed on royalties derived by a resident of the U.S. from sources within the Philippines, was based on the analysis of the following provisions found in the RP-US Tax Treaty particularly Article 13, paragraph 2(b)(iii), in relation to Article 12, paragraph 2(b) of the RP-West Germany Tax Treaty which are all quoted hereunder, thus:

Article 13. (RP-US Tax Treaty)

(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 and registered with the Philippine Board of Investments and engaged in preferred areas of activities; and

(iii) the lowest rate of Philippine tax that may be imposed on royalties of the same kind paid under similar circumstances to a resident of a Third State." (Underscoring supplied)

Article 12(2)(b). (RP-West Germany Tax Treaty)

"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.

(b) 10% of the gross amount of royalties arising from the use of, or the right to use, any patent, trademark, 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.

A careful reading of the abovequoted Article 13 paragraph 2(b)(iii) of the RP-US Tax Treaty reveals that a lower tax rate shall be granted to residents of the United States on royalties derived from the Philippines, if a similar lower rate is granted by the Philippines to a resident of another state by virtue of a tax treaty. Such lower rate is found in the RP-West Germany Tax Treaty, particularly Article 12(2)(b) aforequoted. The interrelationship of the pertinent provisions found in these two tax treaties resulted in a lower tax rate of 10% instead of the 35% originally imposed by the Tax Code.

The relationship of these two tax treaties also dictated certain conditions before the 10% tax rate shall apply. First, the royalties must be derived from the use of, or the right to use industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience. Secondly, the license agreement from where the royalties arose must be registered with Philippine competent authorities.

The evidence presented by herein petitioner reveal that the royalties it received from BPI were as a result of the latter's right to use the former corporation's software (Exhibit "A") and that this agreement entered into between these two companies were duly registered and approved by the Department of Trade and Industry particularly the Technology Transfer Registry of the Bureau of Patents, Trademarks and Technology Transfer (Exhibit "F").

The above discussion settles the legal issue on the rate of withholding tax to be imposed on royalties remitted to a resident of the United States. We are now confronted with the factual aspect of the claim for refund, that is, whether or not petitioner has satisfactorily proven its entitlement to the amount of P1,475,172.68 representing alleged overpaid withholding taxes on royalties for the months of February and June, 1993.

To prove its claim,, petitioner presented the monthly remittance returns of BPI, its withholding agent, for the months of February and June (Exhibit "B" and "C") as well as its Annual Information Return of Income Tax Withheld on Compensation; Expanded and Final Withholding Taxes of BPI for the year 1993 (Exhibit "D"). In addition, petitioner offered the Schedule of Withholding

Taxes on Royalties showing the amounts of P5,900,690.68 and P2,069,241.74, representing the income payments made by BPI and the tax withheld thereon, respectively (Exhibit "E").

Respondent, for her part, did not propose any objection to the aforementioned evidence and limited her arguments to the legal basis of this instant claim for refund. Moreover, respondent did not submit any memorandum nor offered any evidence to refute the legal and factual bases laid down by the petitioner.

In the absence of any substantial objection to the amount claimed, We find the evidence offered by the petitioner sufficient to establish its entitlement to the claim for refund. The amount of P1,475,172.68, represents the difference between the withholding taxes actually paid by petitioner and the correct withholding tax at the rate of 10% on the royalties remitted. The total amount of P1,475,172.67 to be granted to petitioner is computed in detail as follows:

Total amount of royalty	P5,900,690.68
35% Withholding Tax Paid	2,065,241.74
Less: Correct Withholding Tax - 10%	590,069.07
Amount Refundable	P1,475,172.67

WHEREFORE, in view of the foregoing, respondent is hereby **ORDERED** to **REFUND** or **ISSUE** a tax credit certificate in favor of petitioner the amount of P1,475,172.67, representing overpaid income taxes withheld on royalties for the months of February and June 1993.

SO ORDERED.

RAMON O. DE VEYRA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

AMANCIO Q. SAGA
Associate Judge

CERTIFICATION

I hereby certify that the above 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