REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

RHONE POULENC RORER PHILIPPINES, INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 5179

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
JUL 29 1997

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DECISION

This case involves a claim for the refund or tax credit of an alleged overpaid withholding tax on royalty based on the "most favored nation" clause of the R.P.-U.S. Tax Treaty in relation to R.P.-West Germany Tax Treaty in the amount of ₱852,550.37 for the year 1992.

Petitioner is a domestic corporation duly organized and existing under the laws of the Philippines. It is engaged in the manufacture and distribution of certain pharmaceutical products under a License Agreement[1] with Rhone-Poulenc Rorer International (Holdings) Inc. (RPRI-

[1]Executed on August 1, 1988 and valid until February 28, 1991. This agreement was renewed by the parties on March 1, 1991 and is effective up to February 28, 1996.

USA)[2], a non-resident foreign corporation duly organized and existing under Delaware laws with business address at 500 Arcola Road, Collegeville, PA 19426-0107 U.S.A. (Exhs. A and B). This license agreement was duly registered with the Technology Transfer Registry of the Bureau of Patents, Trademarks and Technology Transfer of the Department of Trade and Industry under Certificate of Registration No. 1414, dated February 2, 1993[3] (Exh. D).

For the exclusive license to avail of the technical information and know-how concerning the manufacture and distribution of certain pharmaceutical products, petitioner agreed to pay royalty to RPRI-USA equivalent to 3% of the net sales of the licensed products enumerated in the agreement (see License Agreement, Exh. A, CTA records, p. 69).

From January to November 1992, petitioner subjected its royalty payments to 10% withholding tax pursuant to the "most favored nation" clause of Art. 13 par. 2(b)(iii) of the R.P.-U.S. Tax Treaty in relation to Art. 12 par. 2(b) of the R.P.-West Germany Tax Treaty (Exhs. F to P-4, inclusive). However, respondent issued Revenue

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[2]Formerly Rorer International (Overseas), Inc.

[3]Originally registered under Certificate of Registration No. 904-A, dated February 7, 1991 (Exh. C).

Memorandum Circular (RMC) No. 39-92 on July 1, 1992 revoking all existing ruling and held that:

> A resident of a third State is not entitled to the "most favored nation" tax rate of 10% on royalty income derived from the Philippines because the payment on such tax is not under similar circumstances since there is a matching credit in Germany (20% for royalties), while there is no such similar credit granted by the United States.

And in compliance with RMC No. 39-92, petitioner withheld 25% tax on royalty payment made to RPRI-USA for the month of December 1992 (Exhs. Q to Q-4) and in addition it paid the balance of 15% on royalty payments from January to November 1992 (Exhs. R to R-4), computed as follows:

Month	Royalty	25% Withholding Tax Paid	Date Remitted	Withholding Tax at 10%	Amount Refundable
January 1992	P 486,032.30	P 48,603.23	02.10.92	P 48,603.23	P 0.00
February 1992	941,422.42	94,142.24	03.10.92	94,142.24	0.00
March 1992	377,896.05	37,789.60	04.10.92	37,789.60	0.00
April 1992	430,648.80	43,064.88	05.13.92	43,064.88	0.00
May 1992	340,156.31	34,027.54	06.10.92	34,015.63	11.91
June 1992	434,946.52	43,494.65	07.10.92	43,494.65	0.00
July 1992	406,953.32	40,695.33	08.10.92	40,695.33	0.00
August 1992	373,355.49	37,335.55	09.10.92	37,335.55	0.00
September 1992	692,734.71	69,273.47	10.12.92	69,273.47	0.00
October 1992	599,150.87	59,915.09	11.10.92	59,915.09	0.00
November 1992	483,217.31	48,321.73	12.10.92	48,321.73	0.00
December 1992	117,155.06	29,288.76	01.11.93	11,715.51	17,573.25
15% differential		834,965.21	01.11.93		834,965.21
T O T A L	P5,683,669.16	P1,420,917.28		P568,366.91	P852,550.37

Subsequently, on September 3, 1993, petitioner filed with the Bureau of Internal Revenue a letter-claim for refund (Exhs. S & S-1) of overpaid withholding tax on royalty anchoring its request in the case of IBM Phils. **v. Commissioner of Internal Revenue**, CTA Case No. 4308, **March 31, 1993**, promulgated by this Court stating in substance that "royalties paid by a Philippine Corporation to a US resident are subject to 10% final withholding tax at source in accordance with the 'most favored nation' clause of the R.P.-U.S. Tax Treaty in relation to R.P.-West Germany Tax Treaty".

The inaction of respondent on its claim for refund compelled petitioner to file the instant petition for review on December 20, 1994 in order to toll the running of the two year prescriptive period under Section 230 of the National Internal Revenue Code, as amended.

The sole issue to be resolved by this Court is whether or not petitioner is entitled to the refund of overpaid withholding tax on royalty based on the "most favored nation" clause in the sum of ₱852,550.37.

We find for the petitioner.

The **IBM case** relied by the petitioner, being a controlling case, has long become final and executory as of December 15, 1993 when respondent Commissioner of Internal Revenue withdrew her appeal with the Court of Appeals in the case of Commissioner of Internal Revenue **v. Hon. Court of Tax Appeals & IBM Philippines, Inc., CA G.R. SP No. 31791.**

Quoted hereunder is the pertinent of portion of our decision in the case of IBM Philippines, Inc. v. Commissioner of Internal Revenue, C.T.A. Case No. 4308, *supra*:

> 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.
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> This Court is of the persuasion that petitioner's stand is correct and concurs with the opinion rendered by then Commissioner of Internal Revenue, Bienvenido Tan, Jr., (BIR Ruling No. 456-88, supra., that under the most favored nation provision of the R.P. - U.S. Tax Treaty (Article 13 paragraph 2(b)(iii), the tax imposable on royalties derived by a resident of the United States from sources within the Philippines shall be the lowest rate of Philippine tax that may be imposed on royalties of the same kind paid under similar circumstances to a resident of a third state. Article 12, paragraph 2(b) of the R.P. - West Germany Tax Treaty, provides that royalties arising in the Philippines and paid to 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.
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> 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.

Anent respondent's contention that "petitioner is not entitled to the most favored nation rate of 10% because under Art. 13(2)(b)(i) of the RP-US Tax Treaty said rate maybe availed of only if paid under similar circumstances to a resident of a Third State xxx" has no leg to stand on. This controversy has already been resolved by this Court in a Resolution, dated July 21, 1993, which ruled:

> 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:
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> > "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 paid under similar circumstances to a resident of third state". (Underscoring supplied)
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> 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:
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> > "Under the xxx provisions of the German Tax Treaty, there is a 'matching credit' in Germany of 15% and 20%. A perusal 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 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).

In fact, we have decided along this line in numerous cases of the same issue as herein involve. These cases are **Abbot Laboratories, (Philippines) v. Commissioner of Internal Revenue, CTA Case No. 5119, September 9, 1996 (Entry of Judgment, October 2, 1996)**; S.C. Johnson and **Son, Inc. v. Commissioner of Internal Revenue, CTA Case No. 5136, May 7, 1996 (CA,** affirmed our **decision, November 7, 1996); Armco Marsteel Alloy Corporation vs Commissioner of Internal Revenue,** CTA Case No. 5115; **February 6, 1996; Gillette** (Philippines), Inc. v. **Commissioner of Internal Revenue,** CTA Case No. 4248, **February 8, 1995 (Entry of Judgment,** March 1, 1996); **SmithKline and French Overseas Company** v. **Commissioner of Internal Revenue, CTA Case No.** 5048, September 22, 1995 **(Entry of Judgment, January 30,** 1996); Kimberly-Clark **Corporation (U.S.A.) and** Kimberly-Clark **(Philippines) Inc. v. Commissioner of** Internal **Revenue,** CTA Case No. **4288, January 30, 1992 (CA Entry of Judgment, September**

27, 1994); and General Electric Philippines Meter and **Instrument Co., Inc. v. Commissioner** of **Internal** Revenue, **CTA Case No. 4158, December 5,** 1991 (CA Entry of **Judgment, May 27, 1993).**

Having settled the legal basis of petitioner's claim for refund, what remains is petitioner's compliance with certain requisites as pronounced by this Court in the case of **Jardine Davies, Inc.** and Macwhyte Company, a **Division of Amsted Industries, Inc.** v. Commissioner of **Internal Revenue,** C.T.A. Case No. 5141, April 23, 1996, as follows:

> 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, Decision)

A scrutiny of the evidence presented by petitioner revealed that it has complied with the above requirements. It offered in evidence the License Agreement executed by petitioner Rhone Poulenc Phils. and RPRI-USA (Exh. B) which was duly registered with the Technology Transfer Registry of the Bureau of Patents, Trademarks and Technology Transfer of the Department of

Trade and Industry as evidenced by Certificate of Registration No. 1414 (Exh. D). Furthermore, petitioner was able to substantiate that the amount sought to be refunded were paid and remitted to the Bureau of Internal Revenue as evidenced by the Monthly Remittance Return of Income Taxes Withheld (BIR Form 1743W) bearing the bank machine validations (Exhs. F to R-4, inclusive).

However, it should be pointed out that a claim for refund must be filed within two years from the date of payment of the tax, both with the Bureau of Internal Revenue as well as with this Court. It appears from the record that the amount of P11.91 was paid on June 10, 1992 (Exhs. E and J) while the petition for review was filed only on December 20, 1994. Clearly, six months and 10 days has elapsed from the date of payment of the tax when the instant petition for review was filed with this Court. Thus, we cannot refund the amount of P11.91 due to prescription.

Accordingly, except for the amount of P11.91, the remaining sum of P852,538.46 which was paid on January 11, 1993 is refundable.

WHEREFORE, in view of the foregoing, respondent is hereby ordered to refund or in the alternative, issue a tax credit certificate in favor of petitioner the sum of

P852,538.46, representing overpaid withholding taxes on royalty for the year 1992.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

RAMON O. DE VEYRA
Associate Judge

AMANCIO Q. SAGA
Associate 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