REPUBLIC OF THE PHILIPPINES
Court Of Tax Appeals
QUEZON CITY

SECOND DIVISION

MAERSK FILIPINAS, INC. for and in behalf of A.P. MOLLER-MAERSK A/S, ***Petitioner,***	**C.T.A. CASE NO. 7194**
	Members:
-versus-	CASTAÑEDA, JR., Chairperson UY, and PALANCA-ENRIQUEZ, JJ.
COMMISSIONER OF INTERNAL REVENUE, ***Respondent.***	**Promulgated:** AUG 28 2007

x -- x

DECISION

PALANCA-ENRIQUEZ, J.:

The purpose of the most favored nation clause is to grant to the contracting party treatment not less favorable than that which has been or may be granted to the "most favored" among other countries. The most favored nation clause is intended to establish the principle of equality of international treatment by providing that the citizens or subjects of the contracting nations may enjoy the privileges accorded by either party to those of the most favored nation. The similarity in the circumstances of

ape

280

payment of taxes is a condition for the enjoyment of most favored nation treatment precisely to underscore the need for equality of treatment *(Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc., 309 SCRA 91).*

THE CASE

This is a Petition for Review filed by Maersk Filipinas, Inc., for and in behalf of A.P. Moller-Maersk A/S (hereafter "petitioner") praying for a refund and/or issuance of a tax credit certificate in the amount of P53,763,207.00, representing erroneously paid income taxes on Gross Philippine Billings for the year 2002.

THE FACTS

In their "Joint Stipulation of Facts", the parties stipulated as follows:

> "1. Respondent is the Commissioner of Internal Revenue, vested with the power to decide, approve, and grant refunds or tax credits of overpaid internal revenue taxes as provided by law;
>
> 2. A.P. Moller-Maersk A/S is a corporation organized and existing under the laws of the Kingdom of Denmark, is engaged in business as an international shipping carrier, and is represented by its duly designated shipping agent, the petitioner herein;

281

> 3. Petitioner is a corporation duly organized and existing under the laws of the Philippines engaged in business as a shipping agent with principal office address at 51st Floor, PBCom Building, Ayala Avenue corner Rufino St., Makati City; and
>
> 4. Petitioner filed an administrative claim for refund on behalf of A.P. Moller-Maersk A/S in the aggregate amount of One Hundred Eighteen Million Forty Seven Thousand Six Hundred Forty Nine and 38/100 Pesos (Php118,047,649.38) – Php64,284,649.38 for 2001 and Php53,763,207.00 for 2002- on April 5,2004."

In his Answer, respondent alleged by way of special and affirmative defenses that assuming without admitting that petitioner filed a claim for refund, the same is subject to investigation by the Bureau of Internal Revenue; petitioner failed to show that A.P. Moller-Maersk A/S authorized Maersk Filipinas to institute a claim for refund in its behalf; petitioner failed to demonstrate that the tax, subject of this case, was erroneously or illegally collected; taxes paid and collected are presumed to have been made in accordance with the laws and regulations, hence, not refundable; it is incumbent upon the petitioner to show that it has complied with the provisions of *Section 204(C),* in relation to *Section 229 of the Tax Code, as amended*, and the pertinent provisions of the tax treaties upon which its claimed for refund is premised; in an action for tax refund, the burden is upon the taxpayer to prove that he is entitled thereto, and failure to discharge said burden is fatal to the claim; claims

Oal

282

for refund are construed strictly against the claimant, the same partakes of the nature of exemption from taxation and as such, are looked upon with disfavor.

Petitioner presented Edwin Marasigan, as witness, and submitted documentary evidence, marked as Exhibits *"A"* to *"X"*, inclusive of submarkings, which were all admitted by the Court.

On the other hand, respondent submitted the case for decision, without presenting any evidence.

Thereafter, both parties were ordered to file their simultaneous memoranda, within thirty (30) days from January 17, 2007. Both parties having complied thereto, the case was deemed submitted for decision on April 25, 2007.

Hence, this decision.

ISSUES

As stipulated upon by the parties, the following are the issues for the consideration of this Court:

I

WHETHER OR NOT A.P. MOLLER-MAERSK A/S HAD GROSS SALES OF PHP3,584,213,800 FOR THE TAXABLE YEAR 2002.

OAL

203

II

WHETHER THE GROSS SALES OF A.P. MOLLER-MAERSK A/S FROM THE LOADING AND UNLOADING OF FREIGHT AND CARGO IN THE PHILIPPINES BY ITS INTERNATIONAL VESSELS WERE SUBJECTED TO PHILIPPINE INCOME TAX.

III

WHETHER OR NOT A.P. MOLLER-MAERSK A/S IS ENTITLED TO THE LOWEST TAX RATE THAT MAY BE IMPOSED ON PROFITS UNDER THE RP-KINGDOM OF DENMARK TAX TREATY.

IV

WHETHER OR NOT A.P. MOLLER-MAERSK'S TICKET SALES IS EXEMPT FROM INCOME TAX UNDER THE RP-CYPRUS MERCHANT SHIPPING AGREEMENT IN RELATION TO THE "MOST-FAVORED NATION CLAUSE" OF THE RP-KINGDOM OF DENMARK TAX TREATY.

V

WHETHER OR NOT A.P. MOLLER-MAERSK A/S IS ENTITLED TO A REFUND OF ALLEGED ERRONEOUSLY PAID INCOME TAX IN THE AMOUNT OF PHP53,763,207.00.

Principal Issue

The foregoing issues raised by both parties boil down to the principal issue of whether or not petitioner is entitled to a refund of the

Ore

284

alleged erroneously paid income taxes on Gross Philippine Billings in the amount of P53,763,207.00 for the year 2002.

Petitioner's Arguments

Petitioner mainly contends that it made erroneous payment of income tax on the Gross Philippine Billings of A.P. Moller since the latter is entitled to a tax exemption under the Most Favored Nation Clause of the *RP-Denmark Tax Treaty,* in relation to *Article 12* of the *RP-Cyprus Merchant Shipping Agreement.* It claims that the benefit of tax exemption granted to residents of Cyprus can be extended to international shipping vessels of Danish registry since the profits of A.P. Moller are of the same kind and are derived under similar circumstances by a merchant vessel registered under the flag of Cyprus.

Petitioner further claims that in conjunction to the aforequoted *Article 8, paragraph 2(b)* of the *RP-Denmark Tax Treaty*, or the "most favored nation clause", the lowest Philippine tax rate extended to a resident of a Third State is that extended to merchant vessels bearing the Cyprus flag, pursuant to *Article 12 (1) of the RP-Cyprus Merchant Shipping Agreement*.

285

Respondent's Counterarguments

On the other hand, respondent maintains that the *RP-Cyprus Merchant Shipping Agreement* cited by petitioner does not provide a tax rate, instead it merely states that profits from operation of ships or aircraft in international traffic shall be taxable only in the contracting party where the registered office of the enterprise is situated. Respondent claims that petitioner failed to show that the tax rate where it has a registered office on profits derived under similar circumstances is lower than 1.5% or that the same is exempt from income tax. Respondent further asseverates that the evidence presented by petitioner clearly shows that A.P. Moller-Maersk Philippines' registered office, in so far as taxable year 2002 is concerned, the period covered by its claim, is the Philippines, thus, the revenues petitioner derived from loading and unloading of freight and cargo in the Philippines by its international vessels, were properly subjected to Philippine income tax.

THE RULING OF THE COURT

The petition is devoid of merit.

We rule that petitioner is subject to income tax for income derived from sources within the Philippines considering that A.P. Moller-Maersk A/S, by entering into an Agency Contract with Maersk-Filipinas, Inc., as

286

evidenced by its Agency Agreement (*Exhibit "B"*), is indeed conducting business here in the Philippines. Therefore, petitioner is liable to pay income taxes derived from its transactions within the Philippines, subject to the terms agreed upon in the *RP-Denmark Tax Treaty.*

The *RP-Denmark Tax Treaty* was entered into by the Republic of the Philippines and the Kingdom of Denmark for the purpose of concluding a Convention for the avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income and capital. Thus, petitioner's liability to Philippine income tax is not only provided under the *National Internal Revenue Code of 1997, as amended* (hereafter "*1997 NIRC, as amended*"), but also under the *RP-Denmark Tax Treaty* which provides for certain benefits and exceptions, more particularly *Article 8* thereof, which provides:

"**RP-DENMARK TAX TREATY**

Article 8
Shipping and Air Transport

1. Profits derived by an enterprise which has its place of effective management in a Contracting State from the operation in international traffic of ships or aircraft may be taxed in that State.

2. Notwithstanding the provisions of paragraph 1, profits from sources within the Contracting State derived by an enterprise of

ovl

287

> the other Contracting State from the operation of ships or aircraft in international traffic may be taxed in the first mentioned State but the tax so charged shall not exceed the lesser of:
>
> a.) one and one-half percent of the gross revenues derived from sources in that State; and
>
> b.) the lowest rate of Philippine tax that may be imposed on profits of the same kind derived under similar circumstances by a resident of a third State.
>
> xxx xxx."

The "most favored nation clause" has for its purpose the granting to a contracting state a treatment not less favorable than that which has been or may be extended to the "most favored" among other countries. It has been the intention of the phrase to establish the principle of equality and reciprocity among residents and enterprises of contracting states. In applying the doctrine or principle of the "most favored nation clause", the Supreme Court in the case of *Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc. and Court of Appeals, (301 SCRA 101),* laid down the condition precedent for the entitlement of the "most favored nation clause" and ruled as follows:

> "As stated earlier, the ultimate reason for avoiding double taxation is to encourage foreign investors to

OAL

288

invest in the Philippines – a crucial economic goal for developing countries. The goal of double taxation conventions would be thwarted if such treaties did not provide for effective measures to minimize, if not completely eliminate, the tax burden laid upon the income or capital of the investor. Thus, if the rates of tax are lowered by the state of source, in this case, by the Philippines, there should be a concomitant commitment on the part of the state of residence to grant some form of tax relief, whether this be in the form of a tax credit or exemption. Otherwise, the tax which could have been collected by the Philippine government will simply be collected by another state, defeating the object of the tax treaty since the tax burden imposed upon the investor would remain unrelieved. If the state of residence does not grant some form of tax relief to the investor, no benefit would redound to the Philippines, i.e., increased investment resulting from a favorable tax regime, should it impose a lower tax rate on the royalty earnings of the investor, and it would be better to impose the regular rate rather than lose much-needed revenues to another country.

At the same time, the intention behind the adoption of the provision on 'relief from double taxation' in the two tax treaties in question should be considered in light of the purpose behind the most favored nation clause.

The purpose of a most favored nation clause is to grant to the contracting party the treatment not less favorable than that which has been or may be granted to the "most favored" among other countries. The most favored nation clause is intended to establish the principle of equality of international treatment by providing that the citizens or subjects of the contracting nations may enjoy the privileges accorded by either party to those of the most favored nation. The essence of the principle is to allow the taxpayer in one state to avail of more liberal provisions granted in another tax

ave

289

> 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% on royalties) would derogate from the design behind the most favored nation clause to grant equality or 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."

Pursuant to the above ruling of the Supreme Court, for 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, it is a condition precedent that the subject matter is the same as that in the tax treaty under which the taxpayer is liable. Hence, it must be proven first that the two agreements contain matching circumstances in its provisions and the only difference is the rate of tax.

The relief granted under the *RP-Cyprus Merchant Shipping Agreement* should therefore apply only if the taxes imposed upon income in the *RP-Denmark Tax Treaty* and *RP-Cyprus Merchant Shipping Agreement* are "derived under similar circumstances". Petitioner must be able to prove that the *RP-Denmark Tax Treaty* grants similar tax relief to residents of the Kingdom of Denmark with respect to taxes imposable upon income earned from sources within the Philippines as those allowed to their Cyprian counterparts under the *RP-Cyprus Merchant Shipping Agreement.*

A resolution of this issue requires an examination and comparison of the two agreements, the *RP-Denmark Tax Treaty* and the *RP-Cyprus Merchant Shipping Agreement.*

The RP-Denmark Tax Treaty

The RP-Denmark Tax Treaty was entered into by the Republic of the Philippines and the Kingdom of Denmark for the purpose of concluding a Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital *(Philippine Tax Treaties, 1998 ed., Ordoño, p. 127).*

Thus, in the aforecited case of *Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc. and Court of Appeals, supra*, the Supreme Court elucidated on the purpose of bilateral treaties, as follows:

> "The RP-US Tax Treaty is just one of a number of bilateral treaties which the Philippines has entered into for the avoidance of double taxation. The purpose of these international agreements is to reconcile the national fiscal legislations of the contracting parties in order to help the taxpayer avoid simultaneous taxation in two different

291

> jurisdictions. More precisely, the tax conventions are drafted with a view towards the elimination of international juridical double taxation, which is defined as the imposition of comparable taxes in two or more states on the same taxpayer in respect of the same subject matter and for identical periods. The apparent rationale for doing away with double taxation is to encourage free flow of goods and services and the movement of capital, technology and persons between countries, conditions deemed vital in creating robust and dynamic economies. Foreign investments will only thrive in a fairly predictable and reasonable international investment climate and the protection against double taxation is crucial in creating such a climate.
>
> Double taxation usually takes place when a person is resident of a contracting state and derives income from, or owns capital in, the other contracting state and both states impose tax on that income or capital. In order to eliminate double taxation, a tax treaty resorts to several methods. First, it sets out the respective rights to tax of the state of source or situs and of the state of residence with regard to certain classes of income or capital, both states are given the right to tax, although the amount of tax that may be imposed by the state of source is limited."

Evidently, the *RP-Denmark Tax Treaty* was executed by the parties for the avoidance of double taxation.

<u>The RP-Cyprus Merchant Shipping Agreement</u>

On the other hand, the *RP-Cyprus Merchant Shipping Agreement* is the agreement between the Government of the Republic of the Philippines and the Government of the Republic of Cyprus on the field of merchant shipping. The Agreement states in part: aul

29

> "The Government of the Republic of the Philippines, and the Government of the Republic of Cyprus hereinafter referred to as the "Contracting Parties";
>
> Desiring to strengthen the friendly relations between the two countries and to intensify their economic relations;
>
> Aiming to develop and promote cooperation between the Republic of the Philippines and the Republic of Cyprus in the field of merchant shipping on a mutually advantageous position in accordance with their respective needs and objectives for economic development;
>
> ARTICLE I
>
> The Contracting Parties agree to cooperate on the basis of equal rights, mutual benefit and the principle of freedom of merchant shipping in order to develop the relations between the Republic of the Philippines and the Republic of Cyprus in the field of merchant shipping."

Pursuant to the above provision, the *RP-Cyprus Merchant Shipping Agreement* refers to the agreement entered into by the Philippines and the Republic of Cyprus for the purpose of strengthening and intensifying its friendly and economic relations. Likewise, the Agreement was executed to develop and promote cooperation between the Philippines and Cyprus in the field of merchant shipping, on a mutually advantageous basis in accordance with their respective needs and objectives for economic development.

293

Further, *Article 12* of the *RP-Cyprus Merchant Shipping Agreement,* where petitioner anchors its claim, refers only to the situs of taxation, and does not provide for a tax rate nor a clear and unequivocal exemption from taxation, thus:

> **"RP-CYPRUS MERCHANT SHIPPING AGREEMENT**
>
> **Article 12**
>
> (1) Profits from the operation of a shipping enterprise, registered under the laws and regulations of either of the Contracting Parties, in international traffic, including profits derived from its participation in a pool, a joint business or in an international operation agency, shall be taxable only in the Contracting Party where the registered office of the enterprise is situated."

In other words, the *RP-Cyprus Merchant Shipping Agreement* does not provide for any tax exemption, not even income taxation in general. The *RP-Cyprus Merchant Shipping Agreement* only covers concrete provisions relating to the field of merchant shipping, with a general provision on the issue of the application of tax laws of the contracting parties.

A careful comparison, therefore, of the *RP-Denmark Tax Treaty* and the *RP-Cyprus Merchant Shipping Agreement* reveals that there are

OML

297

no similarities on their subject matter. The *RP-Denmark Tax Treaty* is a treaty for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital, with provisions relating solely to tax liabilities and exemptions. On the other hand, the *RP-Cyprus Merchant Shipping Agreement* refers to provisions relating to the field of merchant shipping. The two agreements have no similar provisions on taxation or on the manner of payment of any tax. In fact, the two international agreements pertain to two entirely different issues and fields.

It is clear that the aforequoted *Article 8* of the *RP-Denmark Tax Treaty* pertains to Shipping and Air Transport, while *Article 12* of the *RP-Cyprus Merchant Shipping Agreement* pertains to Merchant Shipping. Evidently, there are no analogous conditions between the two agreements whereby the phrase "derived under similar circumstances" can hold basis on.

Hence, the condition precedent for the entitlement of the "most favored nation clause", as elucidated by the Supreme Court in the *Johnson case*, is absent in this case. Petitioner, therefore, cannot invoke the "most favored nation clause", and is therefore not entitled to tax benefits granted under the *RP-Cyprus Merchant Shipping Agreement*. It bears stressing that the two covenants relied upon by petitioner were not executed based on the same conditions or considerations, for this reason petitioner cannot apply the privilege granted, if any, to Cyprus residents based on the *RP-Cyprus Merchant Shipping Agreement* to its own liabilities.

Laws granting tax exemption
are construed strictissimi juris
against the taxpayer;
Liberally In
Favor of the Taxing Authority.

The cardinal rule in taxation is that laws granting tax exemption are construed *strictissimi juris* against the taxpayer and liberally in favor of the taxing authority. The tax exemption cannot arise by mere implication and any doubt whether the exemption exists is strictly construed against the taxpayer and in favor of the taxing authority. The law granting exemption must be stated in a clear and unequivocal language.

The burden of proof is upon him who claims the exemption in his favor and he must be able to justify it by the clearest grant of organic or statute law *(Wonder Mechanical Engineering Corp., vs. CTA, 64 SCRA 555).* This burden, petitioner failed to prove.

Obl

214

There being no factual and legal basis for petitioner's claim for a tax refund or credit, the Court is left with no recourse, but to dismiss the petition.

WHEREFORE, premises considered, the present Petition For Review is hereby **DISMISSED**.

SO ORDERED.

OLGA PALANCA-ENRIQUEZ
Associate Justice

WE CONCUR:

JUANITO C. CASTAÑEDA, JR.
Associate Justice

ERLINDA P. UY
Associate Justice

A T T E S T A T I O N

I attest 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's Division.

JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairperson, Second Division

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, and the Division Chairperson's Attestation, 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

298