REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PHILIPPINE REFINING CO., INC.,
Petitioner,

- versus - C.T.A. CASE NO. 2872

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

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D E C I S I O N

This is an appeal from respondent's decision dated March 7, 1977 denying the request for reconsideration of the tax assessments against petitioner in the sums of ₱3,330,617.37 and ₱27,145.[illegible]3 representing deficiency withholding tax at source for the years 1966-1971 and delinquency withholding tax at source for the years 1966-1967, respectively.

As originally demanded in respondent's letter of July 26, 1974, details of the contested tax assessment follow:

1966

Total royalties, dividends & interest remitted		₱2,529,750.00
Withholding tax due thereon		₱ 758,925.00
Less: Amount already paid.	₱629,734.00	
Deduct 25% withholding tax at source on individuals	5,484.00	624,450.00
Balance		₱ 134,475.00
Add: 50% surcharge		₱ 67,2[illegible].50
½% mo. int. fr. 4/16/67 to 4/15/70		24,20[illegible].50
TOTAL AMOUNT DUE AND COLLECTIBLE		₱ 225,918.00

1967

Total royalties, dividends & interests remitted		₱2,925,156.00
Withholding tax due thereon		877,547.00
Less: Amount already paid ..	₱725,942.00	
Deduct 25% withholding tax at source on individuals	4,309.00	721,633.00
Balance		₱ 155,914.00
Add: 50% surcharge		77,957.00
½% mo. int. fr. 4/4/68 to 4/15/71		28,074.00
TOTAL AMOUNT DUE AND COLLECTIBLE		₱ 261,992.52

1968

Total royalties, dividends & interests remitted		₱3,348,332.00
Withholding tax due thereon		₱1,135,708.00
Less: Amount already paid ..	₱823,145.45	
Deduct 25% withholding tax at source on individuals	3,325.00	819,820.00
Balance		₱ 315,888.00
Add: 50% surcharge		157,944.00
Def. interests (6% & 14% per annum)		56,859.00
TOTAL AMOUNT STILL DUE & COLLECTIBLE ...		₱ 530,691.84

1969

Total royalties, dividends & interests remitted		₱6,561,264.00
Withholding tax due thereon		₱2,227,842.00
Less: Amount already paid.	₱2,033,207.14	
Deduct 25% withholding tax at source on individuals	5,836.14	₱2,027,371.00
Balance		₱ 200,471.00
Add: 50% surcharge		100,235.50
Def. interests (6% & 14% per annum)		36,110.97
TOTAL AMOUNT STILL DUE & COLLECTIBLE ...		₱ 336,817.47

1970

Total royalties, dividends & interests remitted		₱2,934,257.00
Withholding tax due thereon		₱1,026,990.00

Less: Amount already paid .. ₱562,870.73		
Deduct 25% withhold-ing tax at source on individuals	6,170.73	556,700.00
Balance		₱ 470,295.00
Add: 50% surcharge		235,147.50
Def. interests (6% & 14% per annum)		110,789.75
TOTAL AMOUNT STILL DUE & COLLECTIBLE ...		₱ 816,232.25

1971

Total royalties, dividends & interests remitted		₱[illegible]
Withholding tax due thereon		₱2,718,972.00
Less: Amount already paid. ₱2,077,605.00		
Deduct 25% withhold-ing tax-at-source on individuals	6,421.00	2,071,184.00
Balance		₱ 647,788.00
Add: 50% surcharge		323,894.00
Def. interests (6% & 14% per annum)		187,340.00
TOTAL AMOUNT STILL DUE & COLLECTIBLE ...		₱1,159,022.00

1966

Withholding tax-at-source per return ...	₱ 629,734.00
Less: Amount already paid on 4/14/67 per OR 926768	314,867.00
Balance	₱ 314,867.00
Add: 1% mo. int. fr. 4/16/67 to 7/14/67	9,446.01
Amount collectible as of 7/14/67	₱ 324,313.01
Less: Amount paid on 7/14/67 per OR 1328675	314,867.00
Balance as of 7/15/67	9,446.01
Add: 1% mo. int. fr. 7/16/67 to 4/16/70	3,117.18
Compromise penalty for late payment	50.00
TOTAL AMOUNT STILL DUE & COLLECTIBLE ...	₱ 12,563.19

1967

Withholding tax-at-source per return ...	₱ 725,942.00
Less: Amount already paid on 4/10/68 per OR 2353230	362,971.00
Balance	₱ 362,971.00
Add. 1% mo. int. fr. 4/16/68 to 7/12/68	10,889.13

Amount collectible as of 7/13/68	₱ 373,[illegible].13
Less: Amount paid on 7/12/68 per OR 3221311	362,871.00
Balance as of 7/13/68	₱ 10,[illegible]7.13
Add: 1% mo. int. fr. 7/1/68 to 4/15/71	3,5[illegible]3.41
Compromise penalty for late payment	50.00
TOTAL AMOUNT STILL DUE & COLLECTIBLE ..	₱ 14,532.54

Petitioner, Philippine Refining Company, Inc. (PRC for short), is a domestic corporation duly organized and existing under and by virtue of the laws of the Philippines. Sometime on May 15, 1962 it entered into an Agreement with the Unilever Limited (Limited for short), a non-resident foreign corporation not engaged in business in the Philippines organized and existing under the laws of England (Exh. "G"). Under this Agreement Limited directly or through its "Associated companies" would render the services:

> 2. IN consideration of the payments to be made by PRC (petitioner) under Clause 3 of this contract, Limited shall, during the continuance of this Agreement, either by itself or at its option through one or more of the Associated Companies, render certain services as hereinafter set out:-
>
> (a) Training
>
> In order to implement Unilever's policy of encouraging nationals of the country of operation to assume positions of responsibility Limited shall provide full-time training within Limited or the Associated Companies for such employees as Limited and PRC may from time to time jointly select. The fares from and returning to the Philippines and the salaries of such employees for the period of their absence from the Philippines shall be for the account of PRC.

(b) <u>Research</u>

Make available to PRC those results of Unilever's research in respect of the Agreement Products that Limited considers to be of mutual benefit for Unilever and PRC.

(c) <u>Availability of Service and Advisory Departments Buying of Raw Materials</u>

(i) Use of its knowledge of and contact with all principal world markets to assist it in handling on PRC's behalf the complex task of purchasing at the most favourable prices such quantities of raw materials as may from time to time be required for the manufacture of the Agreement Products having regard particularly to the need for continuity of supplies and the problems of shipping

(ii) Render such ancillary services in connection with the above including (by way of illustration but not of limitation) providing from time to time market reports with price movements of raw materials in which PRC is interested checking contracts giving packing marking and other instructions to sellers negotiating on quality claims and generally as required from time to time by PRC acting as agent between PRC and buyers and sellers outside of the Philippines.

<u>Buying of Plant, Machinery & Sundry Supplies</u>

Use its best endeavours to purchase as a principal or agent at the best prices its experience enables it to obtain such of PRC's manifold requirements in diverse fields including (by way of illustration but not of limitation) mechanical and electrical plant and equipment and packing materials and sundry supplies for the Agreement Products as PRC shall from time to time request.

Perfumery

Assist PRC by checking such of the Agreement Products as contain perfume for stability of perfume and for compatibility of product with perfume; advice PRC in regard to new perfume and perfumery products for the Philippine market and advise PRC generally in connection with perfumery matters.

General Advisory Services

Make available to PRC the advice of the Unilever Specialist Departments in London on production and technical matters, marketing and distribution, insurance, business administration and financial, legal, taxation and accounting matters.

(d) Trade Marks

Secure to PRC the right during the continuance of this Agreement to apply to the Agreement Products the trade marks referred to in the First Schedule hereto and such further trade marks of Limited or any of the Associated Companies as Limited and PRC may from time to time mutually agree upon.

(e) Communication of Patents Secret Processes etc

Limited shall communicate and make available to PRC for the purposes of the manufacture of the Agreement Products such secret processes inventions and improvements now or hereafter directly or indirectly owned by Limited or any of the Associated Companies as in Limited's opinion are necessary to enable the Agreement Products to be manufactured with the efficiency and to the standards of quality required by Unilever of the Associated Companies.

If any of such secret processes inventions or improvements be communicated and made available to PRC by Limited are protected by Letters Patent or other equivalent protection within the Philippines Limited shall grant or procure to be granted to PRC a royalty-free non-exclusive licence under such Letters Patent or other equivalent protection for the unexpired residue of the term thereof and any prolongation or extension thereof which Limited in its discretion may obtain. Such licence shall be granted with effect from the date hereof in respect of the Letters Patent and Applications for Letters Patent referred to in the Second Schedule hereto. All expense and renewal fees in connection with the granting and maintainance in force of any such Letters Patent or equivalent protection shall be for the account of PRC.

PROVIDED THAT however, nothing herein contained shall impose upon Limited any obligation to accord to PRC priority over any of the Associated Companies in regard to the deployment of any of the services enumerated in this clause 2.

3. (a) In consideration of Limited's securing for PRC the services hereinbefore specified PRC shall pay to Limited within fourteen days of the end of each quarter.-

(i) For the services of training research and of Unilever's Service and Advisory Departments - as specified under (a) (b) and (c) of clause 2 of this contract - a service of 1/2 per cent of the total net sales value of the Agreement Products during the quarter.

(ii) For the services specified under (d) and (e) of this contract a service fee of 1/2 per cent of the total net sales value of the Agreement Products during the quarter.

By all appearances, the case began just the way the tax informer would have wished. The derogatory information furnished the respondent somehow evoking a sense of a deja vu as to petitioner's alleged defrauding the Government of income taxes due by way of declaring as deductions the value of its betterments and improvements instead of capitalizing the same carried over for some 10 years commencing in 1961, drummed an investigation and culminating into the tax assessment demands for 1) deficiency withholding tax at source for the taxable years 1966 to 1971 and delinquency withholding tax per returns for 1966-1967 on findings that the remitted legal and advisory fees to Unilever Limited were actually royalty payments subject to withholding; and 2) deficiency corporate income tax for 1968 consequenced by the increased rates prescribed in R.A. No. 5431.

On July 27, 1974, petitioner protested and sought the reconsideration and cancellation of the assessments. Respondent on March 23, 1976 after due investigation withdrew and cancelled the deficiency corporate income tax assessment of the sum of ₱237,568.88 for the year 1968 for obvious lack of legal basis, but sustained the deficiency withholding tax at source for the years involved (1966-1977 and 1966-1967), supra. Petitioner's request for another reconsideration was denied by the respondent under letter dated March 7, 1977. Hence, this appeal.

By and large respondent Commissioner of Internal Revenue holds on the view that the payments made by petitioner to Unilever Limited, a non-resident foreign corporation not engaged in trade or business in the Philippines are not for services allegedly rendered by the latter, but are actually royalty fees for marketing products carrying the trade marks, labels or names of Unilever Limited which petitioner is licensed to manufacture and sell in the Philippines; that the Agreement between petitioner and Unilever Limited partakes the nature of a license and that whatever training extended to petitioner's personnel, researches to improve or maintain the qualities and standards of the Agreement products, the availability of services, use of trade marks and communications on secret processes in the manufacture of products of Unilever Limited, in the Philippines are all related to the sales of the agreement products in the Philippines and not for services allegedly rendered by said firm; that if the contracting parties intended to treat the alleged services as such, there should have been a contractual price for each and every service actually rendered and not an arbitrary fee on the net sales of the agreement products in the Philippines; as such, the payments made by petitioner to Unilever Limited of London are royalty payments which are income from sources within the Philippines of a non-resident foreign corporation, and, therefore the income tax due thereon should be withheld by petitioner. In a subsequent letter dated March 7, 1977, respondent hastened to rectify that "contrary to your understanding, the assessment of ₱3,330,617.30 is not predicated on the assumption that products of Unilever Limited were exported to the Philippines and sold here by your client (petitioner). Said assessment is based on our findings that the amounts represented as legal and advisory fees, allegedly earned outside the jurisdiction of the Philippines is actually part of the royalty fees payable by your client to manufacture the so-called 'Agreement Products' and apply thereon the trademarks of Unilever products."

Petitioner wraps up its position this wise: "It was agreed that for services under (a), (b) and (c) a service fee of ½% (increased to 1% under Exh. "G-2") of the net sales value of the Agreement Products will be paid by PRC (petitioner) to Unilever. For services under (d) and (e), a service fee of ½% (increased to 1% under Exh. "G-2") of the net sales value of the Agreement Products will be paid by PRC to Unilever. During the years 1966 to 1971 voluminous services were rendered by Unilever in favor of PRC (Exhs. "O" - "P-1"; Exh. "Y"; Exhs. "DD" - "DD-915"; Exhs. "EE" - "EE-859-a") pursuant to the said Agreement (Exh. "G"). Since training, research, assistance in purchasing of materials; purchasing of plant, machinery and sundry supplies;

perfumery and general advisory services were all performed abroad by Unilever Ltd., the remittances made by PRC of its payments for the foregoing services were not subjected to withholding in accordance with Section 37(c)(3) of the Tax Code which considers compensation for services performed outside of the Philippines as income from without the Philippines and therefore not subject to withholding where the recipient of said income is a non-resident foreign corporation not doing business in the Philippines. With regards to the payments by PRC for its use of Unilever's trademarks, patents and secret processes under the Agreement (Exh. "G") said remittances were subjected to withholding (Exhs. "H" - "H-10") together with remittances of dividends, royalties and interests. Prior to 1966 no deficiency income tax assessment and withholding tax assessment similar to the case at bar was made as a result of the BIR investigation of PRC (TSN, p. 46, April 25, 1980 hearing, testimony of Mr. Fernando Manalo). Prior to 1966 and during the period involved in the petition (1966-1971) all remittances were approved by the Central Bank. All of said remittances were deducted by PRC as business expenses in its Corporate Income Tax Returns; no disallowances thereof were ever made by the BIR; and the reasonableness thereof were never questioned by the BIR (TSN, pp. 101-103, April 29, 1980 hearing, testimony of Mr. Fernando Manalo). On the matter by which PRC withheld taxes on the remittances, advice of counsels were solicited and the manner of withholding were upheld by PRC's tax lawyers. (TSN, pp. 44-45, April 25, 1990 hearing, testimony of Mr. Fernando Manalo)."

All told the material facts are relatively simple and so is the issue under review which is essentially addressed to the question of whether or not the petitioner is liable for deficiency withholding tax at source on the represented amounts of legal and advisory fees remitted to the foreign corporation for the taxable years involved.

The case before Us hardly presents a gripping question. The Agreement (Exh. "G") itself furnishes the best means of its own exposition. Enumerated in Clause 2 (Exh. "G-3") are the agreed services of (a) Training, (b) Research, (c) Availability of service and advisory departments, (d) Trademarks, and (e) Communication of patents and secret processes. As pointed out by the petitioner the contract consists mainly of two parts, viz.: 1) Performance of the services constituted in Items (a), (b) and (c) by Unilever Limited in London and 2) Availment of the use of patents, trademarks and secret processes mentioned in Items (d) and (e) by the petitioner in the Philippines.

Further distinction has been drawn for purpose of consideration under Clause 3 (Exh. "G-4") of the Agreement. thus, "For the service of training, research and of Unilever's service and advisory departments - as specified under (a), (b) and (c) of Clause 2 of this contract - a service fee of ½% (increased to 1%) of the total net sales value of the Agreement Products" and "For the services specified under (d) and (e) of this contract a service fee of ½% (increased to 1%) of the total net sales value of the Agreement Products."

If we go by the records, the remittances in payment for the <u>first</u> denominated as <u>legal and advisory fees</u> were deemed compensation for the services rendered outside the Philippines, hence, a non-taxable income of the recipient non-resident foreign corporation not doing business in the Philippines per Section 37([illegible])(3) of the Tax Code. As to the availment of the <u>second</u> the payment in consideration therefor were subjected to withholding tax at source pursuant to Sections 53 and 54 of the Tax Code inasmuch as they are royalties for the license to use the trademarks, patents and secret processes. This appears to be where the petitioner and Unilever Limited stood with respect to the tax consequence brought by the Agreement as construed and implemented since 1962 until the respondent

Commissioner of Internal Revenue rendered the arrange-ment passe' in 1966.

As further disclosed, "During the years 196[illegible] to 1971 voluminous services were rendered by Unilever in favor of PRC (the herein petitioner) (Exhs. "O" - "P-1"; Exh. "Y"; Exhs. "DD" - "DD-915"; Exhs. "EE" - "EE-859-a") pursuant to the Agreement" which explicitly reckoned with the actual performance of the services and stamped a definite resolve as to the locus of the undertaking. If we are right, in our understanding that in determining whether an earned income is from sources within or without the Philippines, the place where the services are performed and not where the compensation is paid, controls (BIR Ruling No. [illegible], July 15, 1960), then the language of Section 37(a)(3) of the Tax Code, supra, poses no ambiguity insofar as the same is brought to bear upon the circumstances of the case at bar. The legal and advisory service fees remitted by the petitioner to Unilever Limited in London "represent charges for such services rendered abroad and, therefore, not subject to Philippine income tax pursuant to Section 37(c) of the Tax Code (Rep. vs. J. Razon, et al. CTA 1556, January 15, 1957; Sec. 16, Rev. Regs. No. 2; BIR Ruling No. 155, May 12, 1961)". Petitioner has fared consistent with law and rule.

Moreover, "Prior to 1966 no deficiency withholding tax assessment on the legal and advisory fees similar to the case at bar was ever made as a result of any BIR investigation of the petitioner. All the remittances were deducted by the petitioner as business expenses in the corporate income tax returns. No disallowances were ever made by the Bureau of Internal Revenue and the reasonableness thereof were never have been questioned by the BIR. Neither was there any showing of any exceptional syndrome of change in the implementation of the terms of the service contract as would warrant a quirk of a variance in the tax treatment on such remittances for the taxable years involved. We therefore hesitate to further fashion an issue into an otherwise satisfactorily settled legal situation.

Although the reach of the issue upon which we rest our decision renders resolution of other subsidiary questions unnecessary, suffice it to state that the apparent contentious quibble on the nature and purpose of the legal and advisory service fees as creating an impression and evoking a connotation of royalty payments, the rulings in Ingram vs. Bowers, 5 F 2d 65; and Oppenheim vs. Commissioner of Internal Revenue, 31 BTA 563, appear in point, that to distinguish between compensation for service and royalty payments one must inquire on whether the payee has