REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SIME DARBY PILIPINAS, INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 5166

COMMISSIONER OF INTERNAL REVENUE
Respondent.

Promulgated: APR 15 1998

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DECISION

This is a judicial claim for the refund of overpaid withholding taxes on royalties paid by petitioner in the amount of P8,805,448.77 for the period covering September 26, 1989 to June, 1992.

The facts are simple.

Pursuant to a Technical Assistance Agreement entered into by petitioner on July 18, 1989 with the Uniroyal Goodrich Tire Company ("UGTC", for brevity), a corporation organized and existing under the laws of the State of New York, United States of America, the latter undertook, *inter alia*, to provide the former with technical information, services and other technical assistance, as well as the rights and licenses appertaining, relative to the manufacture and sale of tires and tire-related products.

In return, petitioner pays a royalty or technical fee in accordance with the following schedule of rates

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based on its net realized sales of the contract products (Exhibit "B", p. 71, CTA records), to wit:

Time Period	Percent of Net Realized Sales
(a) Through June 30, 1989	Three percent (3%)
(b) From July 1, 1989 to December 31, 1989 for	
(i) all BFG-branded contract products	Three percent (3%)
(ii) all other contract products	Two and three fourths percent (2.75%)
(c) From January 1, 1990 to December 31, 1990	Two and one half percent (2.5%)
(d) From January 1, 1991 for remaining term of contract	Two percent (2%)

Consequently, petitioner alleges that it paid royalties to UGTC in the total amount of P58,702,991.67 covering the period September 26, 1989 to June, 1992, and correspondingly withheld and remitted the amount of P5,870,299.16 representing 10% tax in accordance with the "most favored nation" clause under Article 13(2)(iii) of the Republic of the Philippines-United States ("R.P.-U.S.", for short) Tax Treaty in relation with Article 12(2)(b) of the R.P.-West Germany Tax Treaty wherein the preferential tax rate of 10% on royalty payments has been provided.

Events would show, however, that the Bureau of Internal Revenue ("BIR", for brevity) issued on July 1, 1992, Revenue Memorandum Circular ("RMC", for short) No. 39-92 which holds that royalty income derived from Philippine sources paid to U.S. residents shall be taxed at the rate of 25% of the gross royalties and not at the preferential rate of 10%. In effect, RMC No. 39-92 revoked previous BIR rulings and issuances which had allowed the availment of the "most favored nation" clause on payments of royalties to U.S. recipients. Accordingly, taxpayers which paid under the 10% tax rate were given until October 30, 1992 to pay, without penalties, their deficiency royalty taxes amounting to the 15% difference.

In compliance thereof, and in order to avoid a possible deficiency tax assessment, petitioner, on October 30, 1992, paid additional withholding tax to the BIR in the amount of ₱8,805,448.77 representing 15% of its total royalty expense of ₱58,702,991.67, in addition to the taxes it had originally withheld and remitted using the 10% tax rate.

Afterwards, petitioner, in a letter, dated December 17, 1993, and filed on December 20, 1993, claimed for the issuance of a tax credit or refund commensurate to said amount of ₱8,805,448.77 with the Appellate Division of the BIR, invoking as legal basis, Our subsequent ruling in the case of **IBM Philippines, Inc. vs. Commissioner of**

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Internal Revenue, CTA Case No. 4308, promulgated on March 31, 1993, which reaffirmed the preferential tax rate of 10% as the one applicable to royalty payments.

Ironically, petitioner alleged that respondent has neither approved nor denied its administrative claim for refund. Moving thus to preserve its right to a judicial claim for refund or issuance of tax credit within the two-year prescriptive period as prescribed under Section 230 of the Tax Code, as amended, petitioner instituted the present appeal.

At bar, petitioner repleads its stance *a quo*. On the other hand, respondent merely answered, by way of special and affirmative defenses, her oft-repeated *pro forma* argumentation, without any attempt of further elaboration as to why they are being raised at all, that in an action for refund, the taxpayer has the burden of showing that the taxes paid were erroneous or illegally collected; that a claim for refund is construed strictly against the taxpayer and that, petitioner has no cause of action.

Records show that the trial proper of herein case constituted entirely of identification, marking and presentation of formal offer of evidence and memorandum by the petitioner. Readily discernible and quite unfortunate, however, is the kind of unimpressive and lethargic defense conducted by the respondent in this case, as shown by her failure to make even a formal offer of evidence and to submit her memorandum in order to justify her opposition and unexplainable inaction on petitioner's claim for refund both administrative and judicial.

Based on the above antecedents, the issues in the case at bar are as follows:

1) whether or not the 25% tax rate on royalty payments made to U.S. recipients as prescribed under RMC No. 39-92 is in accord with the R.P.-U.S. Tax Treaty in relation with the R.P.-West Germany Tax Treaty;

2) whether or not petitioner has proven the factual requirements of its claim for refund or issuance of tax credit.

After a thorough scrutiny of the facts, disquisition of the parties and the applicable jurisprudence, this Court peremptorily rules in favor of the petitioner.

The first issue involves a purely legal question which had long been settled by this Court through a litany of cases which upheld the original ruling pronounced by then Commissioner of Internal Revenue, Bienvenido Tan, Jr. in BIR Ruling No. 456-88. In that ruling, a 10% tax rate shall be imposed on royalties derived by a resident of the United States from sources within the Philippines pursuant to the "most favored

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nation" provision of the R.P.-U.S. Tax Treaty (Article 12(b)(iii) in relation to Article 12(2)(b) of the R.P.-West Germany Tax Treaty) **(Griffith Laboratories [Phils.], Inc. vs. Commissioner of Internal Revenue, CTA Case No. 5149, September 5, 1997; Warner Lambert Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case Nos. 5163 and 5169, August 25, 1997; Eastern Telecommunications Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 5230, August 5, 1997; G.D. Searle Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 5120, August 5, 1997; Rhone Poulenc Rorer Philippines, Inc. vs. The Commissioner of Internal Revenue, CTA Case No. 5179, July 29, 1997; California Manufacturing Company, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 5186, June 27, 1997; Unisys Australia Limited [Philippine Branch] vs. Commissioner of Internal Revenue, CTA Case No. 5151, June 24, 1997; Wrigley Philippines, Inc. vs. The Commissioner of Internal Revenue, CTA Case No. 5175, April 10, 1997; 3M Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 5118, March 25, 1997; International Flavors and Fragrances [Philippines], Inc. vs. Commissioner of Internal Revenue, CTA Case No. 5127, March 3, 1997; General Milling Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5173, February 19, 1997; BASF**

Coatings and Inks Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 5135, October 1, 1996; Philtread Tire and Rubber Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5117, September 12, 1996; Abbot Laboratories, [Philippines] vs. Commissioner of Internal Revenue, CTA Case No. 5119, September 9, 1996; Amalgamated Specialties Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5105, July 8, 1996; S.C. Johnson and Son, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 5136, May 7, 1996; Armco Marsteel Alloy Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5115, February 6, 1996; Gillette [Philippines], Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4248, February 8, 1995; SmithKline and French Overseas Company vs. Commissioner of Internal Revenue, CTA Case No. 5048, September 22, 1995; IBM Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4308, March 31, 1993; Kimberly-Clark Corporation [U.S.A.] and Kimberly-Clark [Philippines], Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4288, January 30, 1992; General Electric Philippines Meter and Instrument Co., Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4158, December 5, 1991).

Moreover, in the recent Court of Appeals' case of Commissioner of Internal Revenue vs. S.C. Johnson and

Son, Inc., CA-G.R. SP No. 40802, promulgated on November 7, 1996 (which affirmed Our case in S.C. Johnson & Sons, Inc. vs. The Commissioner of Internal Revenue, CTA Case No. 5136, promulgated on May 7, 1996, *supra*; appealed to the Supreme Court), such legal issue has been squarely answered in this wise, to wit:

> The Commissioner of Internal Revenue is now before Us on a petition for review praying that we reverse the appealed decision on the following consideration: The respondent can avail of the tax rate of 10% under the R.P.-West Germany Tax Treaty only if the tax on royalties under the R.P.-U.S. Tax Treaty is paid under similar circumstances as those obtaining in the R.P.-West Germany Tax Treaty pursuant to Article 13, paragraph 2(b)(iii) of the R.P.-U.S. Tax Treaty. The R.P.-West Germany Tax Treaty contains a "matching credit" provision, to wit:
>
> "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:
>
> x x x
>
> (b) Subject to the provisions of German tax law regarding credit for foreign tax, there shall be allowed as a credit against German 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:

x x x

'(dd) royalties: as defined in paragraph 3 of Article 12;

x x x

(c) For the purpose of credit as referred to in sub-paragraph (b), the Philippine tax shall be deemed to be -

'(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 each royalties.

The R.P.-U.S. Tax Treaty contains no similar "matching credit" hence, the tax on royalties under the R.P.-U.S. Tax Treaty is not paid under similar circumstances as those obtaining in the R.P.-West Germany Tax Treaty. Resultantly, the respondent is not entitled to the liberal tax rate provided for under the R.P.-West Germany Tax Treaty.

We do not agree for two main reasons:

One. The BIR Commissioner's interpretation of Article 13(2)(b)(iii) of the R.P.-U.S. Tax Treaty, supra, which is the principal basis of her position in the issue at bench is incorrect. The phrase "paid under similar circumstances" is followed by the phrase "to a resident of a third state". Since what is paid to a resident of a third state is not a tax but a royalty, logic instructs that said provision of the treaty refers to royalties of the same kind paid under similar circumstances to a resident of a third state. *Verba accipiendo*

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sunt secundum materiam. Words are to be understood in the context in which they are used. Article 13, paragraph 2(b)(iii) has nothing to do with the payment of taxes under similar circumstances. We quote with approval the explanation given by IBM Philippines, Inc. in another case which is reproduced in the Comment of the respondent, to wit:

> "The requirement of 'similar circumstances' is in relation to the payment of royalty, 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 Australian 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 circumstance 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 the tax." (p. 9, Comment)

Two. The basis of petitioner BIR Commissioner's position on the issue at bench is RMC 39-92 which, alas, has already been abandoned by that agency no less. As a background, it should be noted that the BIR through the years has been inconsistent on the issue of whether or not American firms are entitled to the "most favored nation" tax rate on royalties derived in this country. Needless to say that this zigzagging policy movements are inimical to public interest for they cause instability in our tax structure. No business house, local or foreign would like to operate in a country where it is made to guess from time to time what is the tax policy or ruling of the revenue collection agency of the State.

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Let us follow the meanderings of the BIR on the issue at bench.

From 1985 to June, 1992, the BIR, in recognition of American firm's entitlement to the "most favored nation' clause under the R.P.-U.S. Tax Treaty, uniformly extended to them the concessional tax rate of 10% on royalties paid by domestic companies to said U.S. companies. This policy was changed when the BIR Commissioner promulgated on July 1, 1992 Revenue Memorandum Circular (RMC) 39-92 which states that an American corporation is not entitled to the "most favored nation" tax rate of 10% on royalty income derived from the Philippines because the payment of such tax is not under similar circumstances considering that there is a matching credit in Germany (20% for royalties), while there is no such similar credit granted by the United States. (This is the same reasoning being foisted by the BIR before this court in the case at bench.)

In 1993, the case of IBM Philippines, Inc. v. Commissioner of Internal Revenue, CTA Case No. 4308, was decided by the Court of Tax Appeals which accorded to the petitioner, an American firm, the benefits of the "most favored nation" clause of the R.P.-U.S. Tax Treaty and therefore ruled that the tax due on royalties derived in the Philippines by said American firm should be taxed 10%. The BIR Commissioner appealed that decision to this court (and docketed herein as Commissioner of Internal Revenue v. IBM Philippines, Inc., CA-G.R. SP No. 31791). The Commissioner subsequently filed a Motion to Withdraw the Petition stating *inter alia* that she had "decided to abide by the decision of the CTA." This decision by the BIR Commissioner to abide by the CTA decision in the IBM Philippines, Inc. case unquestionably superseded RMC 39-92 so that the position of the BIR at that point was that American firms were entitled to the benefits of the "most favored nation" clause under the R.P.-U.S. Tax Treaty.

Not long after, blowing hot and cold, the BIR jettisoned its position following the IBM Philippines, Inc. decision, and went back to its hardlined policy in RMC 39-92. This provoked the filing of the Smithkline and French Overseas Co. v. Commissioner of Internal Revenue, CTA Case No. 5048. This case raised the same issue already put to rest in IBM Philippines, Inc. As expected the CTA decided the case against the BIR and reiterated its decision in the IBM Philippines, Inc. case.

But that was not the end of the BIR's flip-flopping motions. This last time however was for the better. On March 6, 1995, it issued BIR Ruling No. 052-95 expressly revoking BIR Ruling 003-93 issued on January 10, 1993 which applied the discredited RMC 39-92. BIR Ruling No. 052-95 states in part:

> "Such being the case, and in as much as the licensing agreement between you and Guess?, Inc. (USA) has been approved by the Transfer Technology Board of the Department of Trade and Industry, royalties arising in the Philippines and payable to Guess, Inc. (USA) by your company are subject to the Philippine tax at the rate of 10% because this rate appears in the RP-West Germany Tax Treaty and pursuant to Article 13, paragraph 2(b)(iii) of the RP-US Tax Treaty. x x x
>
> This Ruling revokes BIR Ruling No. 003-93 dated January 16, 1993 in view of the Decision of the Court of Appeals in the case of IBM Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4308 dated July 21, 1993."

In view of the foregoing, We are fully convinced of the correctness of the appealed decision.

We do not intend to depart from the wisdom of the foregoing decisions, hence, the same should be applied to the case at bar.

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Going into the last issue, this Court is fully convinced , after a careful and individual scrutiny of the documentary exhibits formally offered in evidence (Exhibits "A" to "R"), that petitioner has sufficiently proven its alleged overpaid withholding taxes on royalties paid to UGTC.

WHEREFORE, in view of the foregoing, the instant Petition for Review is hereby **GRANTED.** Accordingly, respondent is **ORDERED** to **REFUND** or **ISSUE A TAX CREDIT CERTIFICATE** in the amount of **P8,805,448.77** in the name of the petitioner. No costs.

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

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