REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SMITHKLINE & FRENCH OVERSEAS CO.,
Petitioner,

- versus -

C.T.A. CASE NO. 5202

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
APR 15 1998

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DECISION

This is a petition seeking for the refund or issuance of a tax credit certificate in the amount of ₱524,691.85, representing alleged overpaid withholding tax on royalty payments made for the period covering October 1992 to September 1993.

The facts of the case are as follows:

Petitioner is a domestic corporation duly organized and existing under Philippine laws. It is engaged in the manufacture of pharmaceutical and consumer products under an agreement to use certain industrial property rights of Smithkline & French International Co., a corporation duly organized and existing under the laws of the Commonwealth of Pennsylvania, United States of America. This agreement was duly approved by and registered with the Bureau of Patents, Trademarks and Technology Transfer (BPTTT), under Certificate of Registration No. 934 to take effect for a period of five (5) years, or until December 7, 1993.

In consideration for the use of the intellectual property rights of and other related technical services rendered by SmithKline & French International Co., petitioner pays a royalty fee of 3% on the net sales of its pharmaceutical products and 2% on the net sales of its consumer products.

From the quarter ended December 31, 1992 until the quarter ended September 30, 1993, petitioner paid royalties to SmithKline & French International Co. in the total amount of P3,497,948.28, 25% of which was remitted to the Bureau of Internal Revenue as withholding tax, or a total of P874,487.04, broken down as follows:

Exh.	Period		Payments
C	October	1992	P 70,597.96
D	November	1992	97,571.43
E	December	1992	118,237.02
F	January	1993	53,453.60
G	February	1993	61,578.17
H	March	1993	130,709.70
I	April	1993	43,967.32
J	May	1993	58,153.30
K	June	1993	28,538.01
L	July	1993	50,863.89
M	August	1993	69,676.85
N	September	1993	93,108.33
Total amount paid per returns			P876,455.58
Total amount paid per fax messages (Exhibits P, Q, R and S)			P874,487.04

Petitioner paid said amounts in compliance with Revenue Memorandum Circular (RMC) No. 39-92 which revoked previous existing rulings regarding the application of the rate of ten percent (10%) on royalties under the

"Most Favored Nation Clause" of Article 13, paragraph 2 (b)(iii) of the RP-US Tax Treaty, to wit:

> **"Article 13. <u>Royalties.</u>**
>
> 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 royalties;
>
> (ii) 15 percent of the gross amount of the royalties, where the royalties are paid by a Corporation registered with the Philippine Board of Investments and engaged in preferred areas of activities; and
>
> (iii) **<u>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."</u>** (underscoring supplied)

in relation to Article 12, paragraph 2 (b) of the RP-West Germany Tax Treaty which provides:

> 2. x x x 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:

> (a) x x x
>
> (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 information concerning industrial, commercial, or scientific experience.

Under the said RMC, "a resident of a third state (in the particular IBM case, the United States) 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 since there is a matching credit in Germany (20% for royalties), while there is no such similar credit granted by the United States. Respondent holds the view that royalty payments to U.S. licensors are subject to 25% tax ~~rate (or 15% tax rate in the case of a BOI-registered~~ pioneer enterprise).

On ~~March 31, 1993,~~ this Court promulgated the case of **IBM Philippines vs. Commissioner of Internal Revenue, CTA Case No. 4308** where we held that 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 RP-West Germany Tax Treaty and pursuant to Article 13, paragraph 2(b)(iii), of the RP-US Tax Treaty.

Thus, on the strength of this Court's ruling on the aforesaid case, petitioner filed a written claim for refund with respondent's office on February 9, 1994, on the excess fifteen (15%) percent amounting to P524,691.85, computed as follows:

Quarter/royalties	Withholding tax (25%)	Withholding tax (10%)	Difference/ refundable amount
October-December, 1992/ P1,145,625.00	P286,406.00	P114,562.50	P171,843.50
January-March, 1993 P 982,966.00	P245,741.47	P 98,296.60	P147,444.87
April-June, 1993 P 522,635.00	P130,659.00	P 52,263.50	P 78,395.13
July-September, 1993 P 846,722.28	P211,680.57	P 84,672.22	P127,008.35
TOTAL AMOUNT REFUNDABLE			P524,691.85

There being no action on the part of herein respondent, the instant petition was filed on February 20, 1995.

In her Answer, respondent alleged by way of special and Affirmative Defenses that:

> 12) In an action for refund, the taxpayer has the burden to show that the taxes paid were erroneously or illegally collected and failure to do so is fatal to the action;
>
> 13) Claims for tax refunds are construct (sic) strictly against the taxpayer. Taxpayer-petitioner has no cause of action.

The sole issue brought to the fore is whether or not petitioner is entitled to the refund or issuance of a tax credit certificate in the amount of P524,691.85, in accordance with the "most favored nation clause" of the RP-US Tax Treaty, Article 13 (2)(b)(iii) in relation to Article 12(2)(b) of the RP-West Germany Tax Treaty.

During the trial of this case, petitioner's claim for refund gained no strong opposition from the respondent, possibly because the issue involved has already been settled with finality not only with this Court but also in the higher Courts.

Thus, in the light of our previous decisions in cases anchored in factual circumstances on all fours with the instant petition, we rule in favor of petitioner.

In the case of **General Electric Philippines Meter and Instrument Co., Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4158, December 5, 1991**, this Court ruled, thus:

> On the basis of the most favored nation clause of the RP-US Tax Treaty, Art. 13(2)(b)(iii), taken in relation to Art. 12(2)(b) of the RP-West Germany Tax Treaty and BIR Ruling No. 263-86, petitioner should have withheld and paid only 10% tax instead of 25% on the royalties paid by petitioner to General Electric Company in the U.S..
>
> Of the accrued royalties in 1984 in the amount of P15,570,208.22 paid in 1985 - 25% tax was actually paid by petitioner on May 10, 1995 by way of withholding tax in the amount of P81,743.59 (Exhs. I, K & J, pp. 53-54, CTA rec.). Since the tax due thereon is only 10%, according to the above provision of law, the sum of P54,495.73 was due and paid resulting to an overpayment of P27,247.86.

Said decision became final after the Court of Appeals denied petitioner's (herein, respondent) Petition for Review (Commissioner of Internal Revenue vs. General Electric Philippines Meter and Instrument Co., Inc., CA G.R.-No. 30674). The Entry of Judgment was issued on January 26, 1995.

Then, in the earlier mentioned case of IBM Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4308, March 31, 1993 which ruling We reiterated in several succeeding cases, we held:

> 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 RP-West Germany Tax Treaty and not 25% withholding tax on royalties under Articles 13(2)(b)(iii) of the RP-US Tax Treaty.
>
> 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, (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 to such royalties has been approved by Philippine competent authorities,
>
> 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 RP-West Germany Tax Treaty and pursuant to Article 13, paragraph 2(b)(iii), of the RP-US Tax Treaty.

This IBM case relied upon by petitioner has long become final and executory as of December 15, 1993 when respondent CIR withdrew her appeal with the Court of Appeals in the case of Commissioner of Internal Revenue vs. Honorable Court of Tax Appeals and IBM Phils., Inc., CA GR S.P. No. 31791.

However, while the issue on what tax rate to apply in the case of U.S. licensors has already been settled, it is important to note that the imposition of this 10% rate is not without any conditions. In the case of **Jardine Davies, Inc. and MacWhyte Company vs. CIR, CTA Case No. 5141, April 23, 1996,** We laid down the following requirements:

> 1. It is necessary that there be an agreement or a contract whereby the royalties paid to the U.S. must 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.

Petitioner in this case presented the Agreement it entered into with Smith Kline and French International Co. which was registered and approved by the Technology Transfer Board of the Ministry of Trade and Industry for a period of 5 years, from December 5, 1988 to December 7, 1993 (Exh. "A").

And to prove that the amount being claimed as refundable/tax creditable has actually been remitted to the BIR, petitioner presented the Monthly Remittance Returns of Income Taxes Withheld from October 1992 to September 1993 which showed the machine validations of the amounts paid for each return (Exhs. "C", "D", "E", "F", "G", "H", "I", "J", "K", "L", "M" and "N").

With the presentation of all the aforementioned exhibits as well as all the other exhibits which are also material to the issue involved, this Court is convinced to grant to petitioner the refund or issuance of a tax credit certificate but in the reduced amount of P320,776.20 in view of the fact that petitioner's claim for refund from October 1992 to January 1993 were filed beyond the two year-prescriptive period provided for under Section 230 of the Tax Code, to wit:

> SEC. 230. *Recovery of tax erroneously of illegally collected.* - No suit or proceeding

> shall be maintained in any court for the recovery of any national internal revenue tax hereafter alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Commissioner; but such suit or proceeding may be maintained, whether or not such tax, penalty, or sum has been paid under protest or duress.
>
> In any case, no such suit or proceeding **shall be begun after the expiration of two years from the date of payment of the tax or penalty regardless of any supervening cause that may arise after payment:** *Provided, however*, That the Commissioner may, even without written claim therefor, refund or credit any tax, where on the face of the return upon which payment was made, such payment appears clearly to have been erroneously paid. (Underscoring supplied)

Since income subject to final withholding taxes are required to be remitted within ten (10) days after the end of each calendar month (Revenue Regulations 3-93), it follows then that only petitioner's withholding tax payments made from March 9, 1993 up to October 11, 1993 may be given credence, as follows:

Exh.	Period	Tax Paid (25%)	Tax Due (10%)	Refund (15%)
G	February 1993	P 61,578.17	P24,631.27	P 36,946.90
H	March 1993	130,709.70	52,283.88	78,425.82
I to K	April-June, 1993	130,659.00	52,263.50	78,395.13
L to N	July-Sept., 1993	211,680.57	84,672.22	127,008.35
				P320,776.20

WHEREFORE, in view of the foregoing, respondent is hereby **ORDERED** to **REFUND** or in the alternative **ISSUE A TAX CREDIT CERTIFICATE** in favor of the petitioner the sum of P320,776.20 representing overpaid withholding tax on royalty payments for the period beginning February 1993 to September 1993.

SO ORDERED.

AMANCIO Q. SAGA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

RAMON O. DE VEYRA
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