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Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

ABBOTT LABORATORIES, (Philippines),
Petitioner,

- versus -

C.T.A. CASE NO. 5119

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PROMULGATED:
SEP 09 1996

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DECISION

This case involves a claim for refund of overpaid royalties in the amount of ₱3,285,940.21.

Petitioner is a domestic corporation existing under the laws of the Philippines with office at Edsa, Mandaluyong, Metro Manila.

Allegedly, petitioner entered into a Patent and Trademark Agreement and Technological Service Agreement with Abbott International Ltd., a corporation organized and existing under the laws of the State of Delaware, United States of America.

Under the first agreement, petitioner was granted the right to use and exploit certain inventions pertaining to products, active ingredients, processes, formulation and methods of use which are covered by letter patents of the Philippines issued in the name of Abbott International, Ltd. (Abbott International). It also grants to Abbott Philippines the right to use certain formulae, processes and other scientific and technical data necessary to manufacture/compound certain products into pharmaceutical, hospital, nutritional, consumer, diagnostic, veterinary, or agricultural-chemical form.

The second agreement, grants petitioner the right to avail itself of services of Abbott International for the petitioner to develop an efficient and competent management of its business, including services regarding the training of promotional or medical representatives.

Subsequently, petitioner and Abbott International executed an agreement in renewal of the earlier mentioned original agreements. Under said agreement, petitioner pays two percent (2%) of net sales for pharmaceutical, hospital, nutritional and consumer products to Abbott International.

Petitioner alleged that in compliance with RMC No. 39-92, it withheld the 25% tax rate on royalties on its royalty payments to the U.S. licensor from January 1992 to December 1992.

By way of claim, petitioner alleged that it is entitled to a refund in the amount of ₱3,285,940.21 as overpaid withholding tax on royalties for the period January 1992 to December 1993 for withholding the twenty-five percent (25%) tax rate pursuant to RMC No. 39-92. Under this arrangement, it further contends that it is entitled to withhold only the preferential rate of ten percent (10%) by virtue of the RP-US Tax Treaty in relation to the RP-West Germany Tax Treaty.

On March 30, 1994, petitioner filed a claim for refund in the sum of ₱3,285,940.21 with the respondent.

However, respondent has not acted upon petitioner's claim for a refund within the time prescribed by law, thus this petition for review.

Petitioner alleged that under Article 13 (2)(4)(b)(iii) of the said tax treaty, it is entitled to a preferential treatment to residents of the U.S. by allowing them to pay a tax rate lower than the usual rate imposed on royalties derived from sources within the Philippines if a similar lower rate is granted by Philippine taxing authorities to a resident of another state by virtue of a tax treaty. Pertinent thereto, petitioner also held that under Article 12 (2)(b) of the RP-West Germany Tax Treaty, it imposes a lower tax rate of 10% on the gross amount of royalties derived from sources within the Philippines.

More so, with the 10% rate of royalty remittance under Section 2, Article 12 of the RP-West Germany Tax Treaty, petitioner claims that it is entitled to the preferential rate of 10% on royalty remittances insofar as its agreements with Abbott International are registered with and approved by the Technology Transfer Board of the Department of Trade and Industry (DTI) and the approval of the agreements by the DTI retroacted to the date of effectivity of the agreements.

Respondent by the way of special and affirmative defenses alleged among others that:

1. 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;

2. claims for refunds are construed strictly against the taxpayer. Taxpayer-petitioner has no cause of action.

The sole issue posed before Us is whether or not petitioner should be taxed at the rate of 10% withholding tax on royalties in accordance with Article 12 (2) 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.

This is not a case of first impression. A number of cases decided by this Court have consistently affirmed the ruling rendered by then Commissioner of Internal Revenue, Bienvenido Tan (BIR Ruling No. 456-88), where he ruled that 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 ration provision of the R.P.- U.S. Tax Treaty [Article 12, Paragraph 2 (b)(iii)] in relation to Article 12, Paragraph 2 (b) of the R.P.-West Germany Tax Treaty, *(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; General Electric Philippines Meter and Instrument Co. Inc., vs. Commissioner of Internal Revenue, CTA Case No. 4158, December 5, 1991; IBM Philippines, Inc., vs. Commissioner of Internal Revenue, CTA Case No. 4308, March 3, 1993; Kimberly-Clark Corporation (U.S.A.) and Kimberly-Clark (Philippines) Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4288, January 30, 1992).*

Portions of some of the aforementioned cases are quoted hereunder for emphasis:

> "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 said royalties has been approved by Philippine competent authorities." (*IBM Philippines, Incorporated vs. Comm. of Internal Revenue, CTA Case No. 4308*)

> "This Court concurs with the opinion rendered by then Commissioner of Internal Revenue, Bienvenido A. Tan, Jr. (BIR opinion no. 360-87 dated November 13, 1987, Exhibit RR) that pursuant to Article 13, Paragraph 2 (b) (iii) of the R.P.-U.S. Tax Treaty, the tax imposable on royalties derived by a resident of the United States from sources within the Philippines shall be the current 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. In as much as under Article 12, paragraph (2)(b) of the R.P.-West Germany Tax Treaty the tax on royalties imposable to a resident of West Germany shall not exceed 10% of the gross amount of royalties, the lower rate shall apply as well to a resident of the United States." (*Kimberly-Clark Corporation (U.S.A.) and Kimberly-Clark [Philippines] Inc., vs. Commissioner of Internal Revenue, CTA Case No. 4288*)

Insofar as the agreement between Abbott International as well as the Agreement between Abbott Philippines had been registered and approved by the Technology Transfer Registry of the Department of Trade and Industry (DTI), royalties arising in the Philippines and payable to Abbott International as well as to Abbott Philippines 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.-U.S. Tax Treaty.

In support of its claim petitioner presented the following:

1) Schedule of Withholding Tax on Royalties from January 1992 to December 1993.

2) Monthly Remittance Return of Income Taxes Withheld for the period January 1992 to December 1993.

3) Certificate of Registration No. 1153, issued by the Technology Transfer Registry of the Department of Trade and Industry of the Renewal Agreement of the Patent and Trademark Agreement and the Technological Service Agreement between Abbott Laboratories and Abbott International, Ltd., dated February 1, 1991.

4) Renewal Agreement between Abbott Laboratories and Abbott International, Ltd.

For better appreciation Article 13 of the R.P. - U.S. Tax Treaty is herein reproduced to wit:

(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 the 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)*

Pursuant to Article 13 (2)(4)(b)(iii) petitioner is granted preferential treatment to residents of the U.S. by allowing them to pay a tax rate lower than the usual rates imposed on royalties derived from sources within the Philippines if a similar lower rate is granted by Philippine taxing authorities to a resident of another state by virtue of a tax treaty. Such lower rate granted to a resident of another state pursuant to a tax treaty does exist. On January 1, 1985, the RP-West Germany Tax

Treaty took effect. Article 12 (2)(b) of said treaty imposes a lower rate of 10% on the gross amount of royalties derived from sources within the Philippines. The provision in pertinent part provides as follows:

> "2. xxx, such royalties may also be taxed in the Contracting State in which they arise and according to the law of that State in which they arise and according to the law of that State, but the tax so charged shall not exceed.
>
> (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 for information concerning industrial, commercial or scientific experience.

For as long as the transfer of technology under Philippine law is subject to approval, the limitation of the tax rate mentioned under (b) shall, in the case of royalties arising in the Republic of the Philippines, only apply to the contract giving rise to such royalties that have been approved by Philippine competent authorities.

WHEREFORE, respondent is hereby ordered to refund to petitioner the amount of ₱3,285,940.21 representing excess payments of withholding taxes on royalties from January 1992 to December 1993.

SO ORDERED.

RAMON O. DE VEYRA
Associate Judge

I CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

CERTIFICATION

I hereby certify that this decision was reached after due consultation between 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