REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

****

LINDBERG SUBIC, INC.,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA Case No. 8524

Members:

DEL ROSARIO, *Chairperson*
UY, *and*
MINDARO-GRULLA, *JJ.*

Promulgated:
FEB 11 2014, 11:07 a.m.

x - x

DECISION

UY, *J.*:

Before Us is a Petition for Review filed on August 2, 2012 by Lindberg Subic, Inc., petitioner, against the Commissioner of Internal Revenue, respondent, praying that judgment be rendered: (1) declaring the subject Assessment Notices issued by respondent as null and void; (2) directing respondent to cancel and withdraw the assessment for deficiency final withholding tax (FWT) in the aggregate amount of ₱ 1,438,549.22, inclusive of interest and penalties, for the year ended December 31 2007; and (3) prohibiting respondent from enforcing or collecting on the said assessment.

THE FACTS

Petitioner Lindberg Subic, Inc. is a domestic corporation, with principal office at Lot 5 Boton Light and Science Park, Argonaut Highway, Boton Area, SBFZ.[1] It is a corporation duly registered with the Securities and Exchange Commission (SEC) under SEC

[1] Par. 1, Stipulation of Facts, Joint Stipulation of Facts and Issues (JSFI), Docket (Vol. I), p. 215.

0000000302

Registration No. A200108178 dated June 8, 2001, primarily to engage in the trade or business of manufacturing, assembling, fabricating, developing, supplying, licensing, selling at wholesale, importing or otherwise distributing spectacles, spectacle frames and other related products. Petitioner is likewise a duly-registered Subic Bay Metropolitan Authority (SBMA) enterprise, governed by the SBMA rules and regulations.[2]

On the other hand, respondent Commissioner of Internal Revenue is charged with the assessment and collection of all national internal revenue taxes, fees and charges; and enforcement of all forfeitures, penalties and fines connected therewith. She holds office at the Bureau of Internal Revenue (BIR), National Office Building, Diliman, Quezon City.[3]

During the course of its business operations, petitioner contracted a loan on December 20, 2007 with SØHOLT HOVEDGÅRD A/S (SH), a company incorporated in, and a tax resident of Denmark.[4] The amount of the loan is DKK (Danish Kroner) 20,000,000.[5] Pursuant to the said contract, interest was paid by petitioner to SH in 2007 amounting to ₱ 7,667,832.00.[6]

On May 22, 2009, OIC-Regional Director Romulo L. Aguila, Jr. issued Letter of Authority No. 00004164, authorizing Roel Vergel G. Narag and Esperanza G. Castro of Revenue District Office (RDO) No. 19, Subic Bay Freeport Zone, to examine the books of accounts and other accounting records of petitioner for the fiscal year ended December 31, 2007.[7]

A Notice for Informal Conference dated September 8, 2010 was issued to petitioner, which it received on September 13, 2010, inviting petitioner or its duly authorized representative to an informal conference to discuss the preliminary results of the tax audit [*i.e.*, proposed assessment for alleged deficiency income tax (IT), withholding tax on compensation (WTC), fringe benefit tax (FBT), expanded withholding tax (EWT) and final withholding tax (FWT), in the total amount of ₱ 13,062,185.24, inclusive of surcharge, interest and penalties.[8]

---

[2] Par. 2, Stipulation of Facts, JSFI, Docket (Vol. I), pp. 215 to 216.
[3] Par. 3, Stipulation of Facts, JSFI, Docket (Vol. I), p. 216.
[4] Par. 5, Stipulation of Facts, JSFI, Docket (Vol. I), p. 216.
[5] Exhibit "H", Credit Agreement with SH dated 20 December 2007
[6] Par. 5, Stipulation of Facts, JSFI, Docket (Vol. I), p. 216.
[7] Par. 6, Stipulation of Facts, JSFI, Docket (Vol. I), p. 216.
[8] Par. 7, Stipulation of Facts, JSFI, Docket (Vol. I), p. 216.

After discussions and submissions by petitioner, the BIR issued another letter dated November 17, 2011, informing petitioner that the total amount of the proposed assessment was reduced to ₱ 1,752,686.26, inclusive of surcharge, interest and penalties, and requesting petitioner to attend another informal conference on November 28, 2011.[9]

After the informal conference, a Preliminary Assessment Notice was issued by the BIR, which was received by petitioner on January 26, 2012, proposing to assess petitioner for deficiency IT, WTC, FBT, EWT and FWT in the total amount of ₱ 1,763,210.59, inclusive of interests and compromise penalties, detailed as follows:[10]

	Basic	Interest	Compromise Penalty	Totals
IT	6,127.00	4,697.37	1,500.00	12,324.37
WTC	3,848.54	3,142.97	4,000.00	10,991.51
FBT	149,180.81	121,830.99	16,000.00	287,011.80
EWT	19,757.69	16,135.45	4,000.00	39,893.14
FWT	766,783.36	626,206.41	20,000.00	1,412,989.77
			Total Deficiency Taxes	**1,763,210.59**

On 01 February 2012, petitioner, with the conformity of the respondent, paid the assessments for deficiency IT, WTC, FBT and EWT totaling ₱ 350,220.82.[11] The remaining and unpaid assessment represents deficiency FWT on interest on foreign loans of petitioner, plus penalties.[12]

Through its letter dated February 10, 2012, which was filed with the BIR on the same date, petitioner contested the deficiency FWT assessment[13] citing as basis of the 10% tax rate, Article 11(2) of the RP-Denmark Tax Treaty[14] and stating that the conditions for application of the preferential tax rate under said Treaty have been fully complied with.

[9] Par. 8, Stipulation of Facts, JSFI, Docket (Vol. I), p. 217.
[10] Par. 9, Stipulation of Facts, JSFI, Docket (Vol. I), p. 217.
[11] Par. 10, Stipulation of Facts, JSFI, Docket (Vol. I), p. 217.
[12] Exhibit"O", Preliminary Assessment Notice (PAN)dated January 17, 2012, (Assessment No. 019R080400001338). .
[13] Par. 11, Stipulation of Facts, JSFI, Docket (Vol. I), p. 217.
[14] Formally known as the "CONVENTION BETWEEN THE REPUBLIC OF THE PHILIPPINES AND THE KINGDOM OF DENMARK FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME".

On March 21, 2012, petitioner received from the BIR Revenue Region No. 4 the Formal Letter of Demand (FLD) dated March 12, 2012, with Final Assessment Notice and Details of Discrepancy.[15]

On April 19, 2012, petitioner duly filed its letter of the same date, protesting the FLD and invoking the provisions of law and jurisprudence justifying the application of the 10% tax treaty rate, instead of the 20% regular tax rate.[16]

On July 3, 2012, petitioner received the 25 June 2012 Final Decision of the BIR Regional Director, upholding the FLD issued against petitioner and demanding payment of the deficiency FWT assessment for the year ended 31 December 2007, in the aggregate amount of ₱ 1,438,549.22, inclusive of interest and penalties.[17]

Subsequently, the instant Petition for Review was filed on August 2, 2012, seeking the cancellation and nullification of the FLD and the 25 June 2012 Final Decision issued by respondent, through Regional Director Araceli I. Francisco, Ceso IV of Revenue Region No. 4 seeking the collection from petitioner of the alleged deficiency FWT for the year ended 31 December 2007.[18]

On October 16, 2012, respondent filed her Answer,[19] invoking the following special and affirmative defenses, to wit:

> "10. Petitioner Lindberg Subic is liable to pay deficiency Final Withholding Tax in the amount of One Million Four Hundred Thirty-Eight Thousand Five Hundred Forty Nine Pesos and 22/100 (P1,438,549.22) for the taxable year 2007. Petitioner claims that the Final Withholding Tax on interest accrued on the loan it contracted with Soeholt Hovedgaard AS is subject to 10% provided under Article II (a) of the RP-Denmark Tax Treaty. Petitioner, however, failed to comply with the requirements set forth in Revenue Memorandum Oder NO. 1-2000 which provides:
>
> I. Objectives:

[15] Par. 12, Stipulation of Facts, JSFI, Docket (Vol. I), p. 217.
[16] Par. 13, Stipulation of Facts, JSFI, Docket (Vol. I), p. 218.
[17] Par. 14, Stipulation of Facts, JSFI, Docket (Vol. I), p. 218.
[18] Par. 15, Stipulation of Facts, JSFI, Docket (Vol. I), p. 218.
[19] Docket (Vol. I), pp. 170 to 183.

This order is issued to streamline the processing of tax treaty relief application in order to improve efficiency and service to the taxpayers. Furthermore, it is to the best interest of both the taxpayer and the Bureau of Internal Revenue that any availment of tax treaty provision be preceded by an application for tax treaty relief with the International Tax Affairs Division (ITAD). In this way, the consequences of any erroneous interpretation and/or application of the treaty provisions (i.e. claim for refund/credit for overpayment of taxes, or deficiency tax liabilities for underpayment) can be averted before proceeding with the transaction and or paying tax liability covered by tax treaty.

II. Coverage

This order covers exclusively applications for tax treaty relief, including claims or request for tax exemption, preferential tax treaty rate, refund or credit of taxes on the following income derived by the taxpayer under existing tax treaties to wit:

xxx

III. Policies

In order to achieve the above-mentioned objectives, the following policies shall be observed:

1. The processing for tax treaty relief shall be transferred from Law Division to International Tax Affairs Division (ITAD) in accordance with the approved memorandum dated March 23, 1999.
2. Any availment of tax treaty relief must be preceded by an application by filing BIR Form No. 0901 (Application for Relief from Double Taxation) with ITAD at least fifteen (15) days before the transaction accompanied by supporting documents justifying the relief xxx.
3. Claims for tax credit/refund pertinent to the tax treaty relief requested filed with ITAD within the two (2) year period prescribed by Section 229 of the NIRC, as amended under RA 8424.

xxx

IV. Procedures

1. Taxpayer
   1.1 Accomplish new BIR form 0901-Application for Relief from Double Taxation.
   1.2 File BIR Form with ITAD at least 15 days before the transaction with all the supporting documents justifying the relief sought.
   1.3 Attach any Withholding Tax Return Form 1743W/new computerized BIR Form 1601 (covering final withholding taxes based on the preferential tax treaty rate for income payments to non-residents), a copy of accomplished BIR Form 0901 duly acknowledged/received by ITAD, or when available, the approved ruling as proof of the availment of the preferential tax treaty treatment.

2. ITAD
   2.1 Check completeness and validity of the documents submitted.
   2.2 Review the application and/or determine whether the applicant is entitled to the relief or tax refund/credit requested.
      2.2.1 In case of claims for credit/refund, verify with revenue accounting Division the remittance of applicable taxes, and with the Collection Division of the respective Revenue Region for any outstanding tax liabilities of the concerned taxpayer.

xxx

11. It bears stressing that the said Revenue Memorandum Order provides that, any availment of tax treaty relief must be preceded by an application, by filing BIR Form No. 0901 (Application for Relief from Double Taxation) with ITAD at least fifteen (15) days before the transaction, accompanied by supporting documents justifying the relief sought. Accordingly, the assessment issued by the respondent Commissioner of Internal Revenue, through its Regional Director imposing 20% final withholding tax on the accrued interest on loan is valid,

pursuant to Section 28(B)(5)(a) of the NIRC. The said law states:

> SEC. 28. *Rates of Income Tax on Foreign Corporations.—*
>
> xxx
>
> (B) Tax on Nonresident Foreign Corporation.—
>
> xxx
>
> (5) *Tax on Certain Incomes Received by a Nonresident Foreign Corporation.—* (a) *Interest on Foreign Loans.* — A final withholding tax at the rate of twenty percent (20%) is hereby imposed on the amount of interest on foreign loans contracted on or after August 1, 1986;
>
> xxx

12. The law provides that the power to interpret provisions of the Tax Code and other tax laws shall be under the exclusive and original jurisdiction of the Commissioner of Internal Revenue. 'The interpretation given by the administrative officer charged by reason of his office to carry out the provisions of the statute should be respected whenever such interpretation is assailed by someone who alleges no reasons of weight to contradict or weaken it'. Thus, the issuance by the Commissioner of Internal Revenue of the said rulings and the application of Section 28(B)(5)(a) of the NIRC is anchored on her interpretation that all the requirements set forth in RMO 1-2000 must be complied with before one can avail of the 10% preferential tax rate under the tax treaty. Respondent correctly applied the 20% rate of final tax on the interest paid by the petitioner on its foreign loan. 'The law concedes to administrative bodies the authority to act on and decide claims and applications in accordance with their judgment in the exercise of their adjudicatory capacity. Because of their required expertise in specific matters within the purview of their respective jurisdictions, the findings of these administrative bodies merit not only great weight but also respect and finality'.

13. The records of this case revealed that petitioner did not file an application for tax treaty relief in accordance

with RMO 1-2000. Petitioner insists in applying the 10% preferential rate under the RP-Denmark Tax Treaty by merely invoking the principle of pacta sunt servanda and nothing more. The basis of petitioner has no leg to stand on but instead bolsters respondent's imposition of 20% final tax on interest paid by the petitioner on foreign loans it contracted. The deficiency final withholding tax is computed as follows:

Interest on Foreign Loans	P7,667,832.00
Multiply by	20%
Final Withholding Tax Due	P1,533,566.40
Less: Amount Paid	P766,783.04
Balance	766,783.36
20% interest per annum	651,765.86
Compromise penalty	20,000.00
TOTAL DEFICIENCY FINAL WITHHOLDING TAX	P1,438,549.22

14. Petitioner's claim that tax treaty should prevail over the tax code has no basis. It is a settled rule that in case of conflict between municipal law and international law, municipal law must prevail and should be upheld by our courts. In cases decided by the Supreme Court, it held, **'In a situation, however, where the conflict is irreconcilable and a choice has to be made between a rule of international law and municipal law, jurisprudence dictates that municipal law should be upheld by the municipal courts** (Ichong vs. Hernandez, 101 Phil. 1155 [1957]; Gonzales vs. Hechanova, 9 SCRA 230 [1963; In re: Garcia, 2 SCRA 984 [1961]) **for the reason that such courts are organs of municipal law and are accordingly bound by it in all circumstances. The fact that international law has been made part of the law of the land does not pertain to or imply the primacy of international law over national or municipal law in the municipal sphere.**

15. The doctrine of incorporation, as applied in most countries, decrees that rules of international law are given equal standing with, but are not superior to, national legislative enactments. **The fact that international law has been made part of the law of the land does not by any means imply the primacy of international law over national law in the municipal sphere**. Under the doctrine of incorporation as applied in most countries, rules of International Law are given a standing equal, **not superior, to national legislative enactments.**

0000000809

16. Petitioner's contentions that the requirement to file an application for tax treaty as mandated under RMO No. 1-2000 is merely advisory and recommendatory, is misplaced. A Revenue Regulation, the issuance of which is authorized by statute, has the force and effect of law. The authority of the Secretary of Finance, in conjunction with the Commissioner of Internal Revenue, to promulgate all needful rules and regulations for the effective enforcement of internal revenue laws cannot be controverted. Neither can it be disputed that such rules and regulations, as well as administrative opinions and rulings, ordinarily should deserve weight and respect by the courts. Much more fundamental than either of the above, however, all such issuances must not override, but must remain consistent and in harmony with, the law they seek to apply and implement. Administrative rules and regulations are intended to carry out, neither to supplant not to modify, the law.

17. In the case Commissioner of Internal Revenue v. CBK Power Ltd., this Honorable Court held that prior application for tax treaty relief is required before a taxpayer can avail of the preferential tax treatment under the tax treaties. It further states that 'it is to the best interest of both the taxpayer and the BIR that any availment of the tax treaty provision be preceded by an application for treaty relief with the ITAD. In this way, the consequence of any erroneous interpretation and/or application of the treaty provision can be averted before proceeding with the transaction and or paying the tax liability covered by the tax treaty.'

18. Further, in the case of First Sumiden Realty Inc. vs Commissioner of Internal Revenue, citing the case of Mirant (Philippines) Operations Corporation (formerly: Southern Energy Asia-Pacific Operations [Phils.] Inc.) v. Commissioner of Internal Revenue, this Honorable Court states: 'Contrary to petitioner's allegations, the issue on whether an application for treaty relief is required prior to the application for treaty relief with the BIR's International Tax Affairs Division(ITAD) has already been settled in the case Mirant(Philippines) Operations Corporation (formerly: Southern EnergyAsia-Pacific Operations [Phils.] v. Commissioner ofInternal Revenue. In the said case, the Honorable Court of Tax Appeals *en banc* ruled that:

0000000310

> 'However, it must be remembered that a foreign corporation wishing to avail of the benefits of the tax treaty should invoke the provisions of the tax treaty and prove that indeed the provisions of the tax treaty applies to it before the benefits may be extended to such corporation. In other words, a resident or non-resident corporation shall be taxed according to the provisions of the National Internal Revenue Code, unless it is shown that the treaty provisions apply to the said corporation, and that, in cases the same are applicable, the option to avail of the tax benefits under the tax treaty has been successfully invoked. Under Revenue Memorandum Order 01-2000 of the Bureau of Internal Revenue, it is provided that the availment of a tax treaty provision must be preceded by an application for a tax treaty relief with its International Tax Affairs Division (ITAD). This is to prevent any erroneous interpretation and/or application of the treaty provisions with which the Philippines is a signatory to. The implementation of the said Revenue Memorandum Order is in harmony with the objectives of the contracting state to ensure that the granting of the benefits under the tax treaties are enjoyed by the persons or corporation duly entitled to the same.' As consistently held by the Honorable Court of Tax Appeals and pursuant to the above-mentioned case, **a ruling from the BIR must be secured prior to the availment of a preferential tax rate under a tax treaty.**'

19. Lastly, 'tax assessment by tax examiners are presumed correct and made in good faith. The taxpayer has the duty to prove otherwise. In the absence of proof of any irregularities in the performance of duties, an assessment duly made by the Bureau of Internal Revenue examiner and approved by his superior officers will not be disturbed. All presumptions are in favor of the correctness of tax assessments.' As a logical consequence of this presumption, the burden of proof is on the taxpayer contesting the validity or correctness of an assessment to prove not only that the Commissioner of Internal Revenue is wrong, but that he is right. Failure to present proof of error in the assessment will justify judicial affirmation of said assessment."

During Pre-trial Conference held on January 18, 2013, the parties entered into stipulation of facts and issues, identification of the parties' respective documentary evidence and witnesses. On the basis thereof, and as directed by the Court, the parties submitted their Joint Stipulation of Facts and Issues on February 4, 2013; followed by a Supplemental Joint Stipulation of Facts and Issues filed on February 25, 2013, which was approved in the Resolution dated March 1, 2013.[20] Thereafter, the Court issued a Pre-trial Order dated March 22, 2013.[21]

During trial, petitioner presented two (2) witnesses, namely: Florence C. Naval and Bo Brinch-Iversen. Thereafter, petitioner formally offered its evidence on June 6, 2013.[22]

In the Resolution dated August 22, 2013,[23] petitioner's evidence were admitted by this Court, with the exception of Exhibits "D", "K-1" and "HH", for failure of petitioner to submit the original or present the same for comparison, and Exhibits "W", "X", "Y", "Z", "GG", and "HH", for failure of petitioner to present a witness to identify the same in open court. Moroever, the Court took judicial notice of Exhibits "II", "JJ", and "KK" .

With respect to the presentation of respondent's evidence, respondent earlier filed a Manifestation on May 21, 2013 alleging that she will not be presenting evidence in this case and requested for a period of thirty (30) days from receipt of the Court's resolution of Petitioner's Formal Offer of Evidence within which to file her Memorandum.[24]

Thus, in the Resolution dated September 3, 2013, the parties were directed by the Court to file their respective memoranda.[25] With the filing of petitioner's Memorandum on October 11, 2013,[26] and respondent's Memorandum on October 14, 2013,[27] this case was submitted for decision on October 22, 2013.[28]

Hence, this Decision.

[20] Docket (Vol. I), p. 456.
[21] Docket (Vol. I), pp. 467 to 476.
[22] Docket (Vol. II), pp. 718 to 738.
[23] Docket (Vol. II), pp. 755 to 757.
[24] Respondent's Manifestation filed on May 21, 2013, Docket (Vol. II), pp. 707 to 708
[25] Docket (Vol. II), p. 759.
[26] Docket, (Vol. II), pp. 760-781
[27] Docket,(Vol. II) pp. 782-795
[28] Resolution dated October 22, 2013, Docket, p.797

THE ISSUE

As stipulated by the parties, these are the issues submitted for the resolution of the Court, to wit:

> "a. Whether a prior application for tax treaty relief is mandatory for the entitlement to the preferred rate of interest on foreign loans under the RP-Denmark tax treaty; and
>
> b. Whether petitioner is liable to pay deficiency FWT in the amount of One Million Four Hundred Thirty-Eight Thousand Five Hundred Forty-Nine Pesos & 22/100 (₱ 1,438,549.22) for the taxable year 2007." [29]

Petitioner's arguments:

Petitioner argues that the interest income paid to SH shall be governed by the RP-Denmark Tax Treaty, having the force and effect of a municipal law and following the principle of *pacta sunt servanda.* Petitioner points out that the RP-Denmark Tax Treaty does not require a prior application for tax treaty relief before petitioner may enjoy the benefits provided therein and that the said treaty may not be modified by a mere administrative issuance.

Petitioner also asserts that the RP-Denmark Tax Treaty may not be modified by a mere administrative issuance.

Lastly, petitioner contends that it has complied with the conditions for the availment of the preferential tax treaty rate under the RP-Denmark Tax Treaty, and has properly withheld and remitted the correct amount of withholding tax on interest. Thus, according to petitioner, it is not liable to pay the deficiency FWT on its interest payments for taxable year 2007.

Respondent's counter-arguments:

Respondent counter-argues that the imposition of 20% final withholding tax on interest paid by petitioner on its foreign loans in accordance with Section 28(5)(a) of the National Internal Revenue

[29] Stipulation of Issues, JSFI, Docket, p. 218.

Code (NIRC) is correct considering that petitioner failed to file an application for tax treaty relief as required under Revenue Memorandum Order No. 1-2000 (RMO No. 1-2000). Respondent submits that RMO No. 1-2000 partakes of the nature of a statute and has in its favor a presumption of constitutionality.

Respondent further asserts that the NIRC must prevail over the RP-Denmark Tax Treaty because jurisprudence dictates that in case of conflict between international and municipal laws, municipal law should be upheld by the courts.

In other words, respondent claims that an application for tax treaty relief is mandatory in nature and non-compliance thereto is fatal to petitioner's availment of the preferential tax rate provided by the treaty.

Finally, respondent points out that tax assessments by tax examiners are presumed correct and made in good faith and the taxpayer has the duty to prove otherwise.

THE COURT'S RULING

The instant Petition for Review is meritorious.

A prior application for tax treaty relief is not mandatory before a taxpayer can avail of the preferential tax treatments under Philippine tax treaties.

Petitioner is being assessed for underpayment of its final withholding tax liability on interest pursuant to Section 28(B)(5)(a) of the NIRC, computed as follows:[30]

Interest on Foreign Loans	P 7,667,832.00
Multiply by	20%
Final Withholding Tax Due	P 1,533,566.40
Less: Paid	766.783.04
Balance	P 766,783.36
20% Interest p.a.	651,765.86
Compromise Penalty	20,000.00
Total Deficiency Final Withholding Tax	**P 1,438,549.22**

[30] Exhibit "P", Formal Letter of Demand (FLD) dated March 12, 2012.

Respondent maintains that petitioner cannot apply the 10% preferential tax rate under the RP-Denmark Tax Treaty because it failed to secure a prior application for tax treaty relief as provided under RMO No. 1-2000[31]. Respondent insists that RMO No. 1-2000, requiring taxpayers to file a tax-treaty relief application with the BIR International Tax Affairs Division (ITAD) at least fifteen (15) days before the intended transaction or payment of income, is mandatory before a taxpayer may be entitled to the preferential tax rates provided under Philippine tax treaties.

To further bolster its assertion, respondent refers to previous decisions of this Court,[32] where it was ruled that a prior application for tax treaty relief is a necessary requirement for the availment of tax treaty provisions.

The Court disagrees with respondent.

Respondent's arguments are contrary to the recent pronouncement of the Supreme Court in ***Deutsche Bank AG Manila Branch vs. Commissioner of Internal Revenue***.[33] In the said case, the Supreme Court categorically ruled that non-compliance with RMO No. 1-2000 does not automatically deprive a taxpayer of the benefits provided under Philippine tax treaties. The Supreme Court explains:

> "Our Constitution provides for adherence to the general principles of international law as part of the law of the land. The time-honored international principle of *pacta sunt servanda* demands the performance in good faith of treaty obligations on the part of the states that enter into the agreement. Every treaty in force is binding upon the parties, and the obligations under the treaty must be performed by them in good faith. More importantly, treaties have the force and effect of law in this jurisdiction.
>
> Tax treaties are entered into 'to reconcile the national fiscal legislations of the contracting parties and, in turn, help the taxpayer avoid simultaneous taxations in two different jurisdictions. *CIR v. S.C. Johnson and Son, Inc.* further clarifies that 'tax conventions are drafted with

[31] Procedures for Processing Tax Treaty Relief Application.
[32] In its Answer, respondent cites the cases of *Commissioner of Internal Revenue vs. CBK Power Ltd.*, CTA EB Case No. 469, and *First Sumiden realty Inc. vs. Commissioner of Internal Revenue*, CTA Case No. 8151, September 27, 2012.
[33] G.R. No. 188550, August 19, 2013.

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 the 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 climate.' Simply put, tax treaties are entered into to minimize, if not eliminate the harshness of international juridical double taxation, which is why they are also known as double tax treaty or double tax agreements.

'A state that has contracted valid international obligations is bound to make in its legislations those modifications that may be necessary to ensure the fulfillment of the obligations undertaken.' Thus, laws and issuances must ensure that the reliefs granted under tax treaties are accorded to the parties entitled thereto. **The BIR must not impose additional requirements that would negate the availment of the reliefs provided for under international agreements**. **More so, when the RP-Germany Tax Treaty does not provide for any pre-requisite for the availment of the benefits under said agreement.**

Likewise, it must be stressed that there is nothing in RMO No. 1-2000 which would indicate a deprivation of entitlement to a tax treaty relief for failure to comply with the 15-day period. We recognize the clear intention of the BIR in implementing RMO No. 1-2000, but the CTA's outright denial of a tax treaty relief for failure to strictly comply with the prescribed period is not in harmony with the objectives of the contracting state to ensure that the benefits granted under tax treaties are enjoyed by duly entitled persons or corporations.

Bearing in mind the rationale of tax treaties, the period of application for the availment of tax treaty relief as required by RMO No. 1-2000 should not operate to divest entitlement to the relief as it would constitute a

> violation of the duty required by good faith in complying with the tax treaty. The denial of the availment of tax relief for the failure of a taxpayer to apply within the prescribed period under the administrative issuance would impair the value of the tax treaty. At most, the application for a tax treaty relief from the BIR should merely operate to confirm the entitlement of the taxpayer to the relief.
>
> The obligation to comply with a tax treaty must take precedence over the objective of RMO No. 1-2000. Logically, noncompliance with tax treaties has negative implications on international relations, and unduly discourages foreign investors. While the consequences sought to be prevented by RMO No. 1-2000 involve an administrative procedure, these may be remedied through other system management process, *e.g.*, the imposition of a fine or penalty. **But we cannot totally deprive those who are entitled to the benefit of a treaty for failure to strictly comply with an administrative issuance requiring application for tax treaty relief.**"

It is clear from the foregoing jurisprudential pronouncement that a prior application for tax treaty relief is not mandatory before a taxpayer may enjoy the reliefs provided under Philippine tax treaties; more so, when the tax treaty itself does not provide for any pre-requisite for the availment of the benefits provided therein. Simply put, failure to secure a tax treaty relief application does not automatically divest a taxpayer of its entitlement to the benefits granted under tax treaties.

This Court is duty bound to adhere to precedents laid down by the Supreme Court, as in the foregoing case. Apropos, We cannot outrightly deny the instant Petition for Review solely on the basis of petitioner's noncompliance with RMO No. 1-2000. All the more so when the RP-Denmark Tax Treaty clearly does not provide for any pre-requisite for the availment of the benefits under said agreement.

Hence, notwithstanding the absence of a tax treaty relief, which merely serves to confirm entitlement to such relief, petitioner may apply the 10% preferential tax rate, provided all requirements set forth under the RP-Demark Tax Treaty have been complied with, as will be determined hereafter.

Anent respondent's reliance upon previous decisions of this Court upholding the mandatory nature of RMO No. 1-2000, suffice it to state that decisions of this Court do not constitute precedents and are not binding upon the public.[34] The Supreme Court, as the Final Arbiter of any justiciable controversy, has the last word on what the law is. Its decision becomes a judicial precedent to be followed in subsequent cases brought before the court for determination.[35]

Petitioner is entitled to the preferential tax rate of 10% under the RP-Denmark Tax Treaty on subject interest income.

Indeed, Section 28(B)(5)(a) of the NIRC of 1997 imposes income tax on foreign loans as follows:

> "SEC. 28. *Rates of Income Tax on Foreign Corporations.—*
>
> xxx xxx xxx
>
> (B) *Tax on Nonresident Foreign Corporations.—*
>
> xxx xxx xxx
>
> (5) *Tax on Certain Incomes Received by a Nonresident Foreign Corporation.—*
>
> (a) *Interest on Foreign Loans.* — **A final withholding tax at the rate of twenty percent (20%) is hereby imposed on the amount of interest on foreign loans** contracted on or after August 1, 1986;" *(Emphasis supplied)*

Parenthetically, the term "foreign loan" refers to loan contracts including all debt items, whether in kind or in cash, which are payable in foreign currency or in kind entered into by a Philippine resident, corporate or otherwise, with a non-resident.[36]

---

[34] *Commissioner of Internal Revenue vs. San Roque Power Corporation; Taganito Mining Corporation vs. Commissioner of Internal Revenue; Philex Mining Corporation vs. Commissioner of Internal Revenue,* G.R. Nos. 187485, 196113 and 197156, February 12, 2013.

[35] *Commissioner of Internal Revenue vs. Michel J. Lhuillier Pawnshop, Inc.,* G.R. No. 150947, July 15, 2003, citing GSIS v. Court of Appeals, 334 Phil. 163, 175 [1997].

[36] Section 2, Revenue Regulations No. 4-75.

However, it must be emphasized that the foregoing tax imposition may be reduced to the extent required by any treaty obligation binding upon the Philippine government, pursuant to Section 32(B)(5) of the same Code, to wit:

> "SEC. 32. *Gross Income.—*
>
> xxx xxx xxx
>
> (B) *Exclusions from Gross Income.—* **The following items shall not be included in gross income and shall be exempt from taxation** under this Title:
>
> xxx xxx xxx
>
> (5) ***Income Exempt under Treaty.—*** **Income of any kind, to the extent required by any treaty obligation binding upon the Government of the Philippines.**" *(Emphases and underscoring supplied)*

In this case, petitioner claims that on the basis of Article 11 of the RP-Denmark Tax Treaty, it is entitled to the preferential tax rate of 10% on interest payments. In addition, petitioner contends that it has fully complied with the conditions for the availment of the preferential tax rate on interest under the said tax treaty and has properly withheld and remitted the correct amount of withholding tax.

We agree with petitioner.

Article 11 of the RP-Denmark Tax Treaty provides:

> "**ARTICLE 11**
> *Interest*
>
> 1. Interest arising in a Contracting State paid to a resident of the other Contracting State may be taxed in that other State.
>
> 2. However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State the tax so charged shall not exceed 10 percent of the gross amount of interest.

The competent authorities of the Contracting States may by mutual agreement settle the mode of application of this limitation.

xxx xxx xxx

4. The term 'interest' as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.

xxx xxx xxx."

Based on the foregoing treaty provisions, petitioner must show compliance with the following requirements for the application of the 10% preferential tax rate on interest:

1. Income paid is interest arising from a debt-claims of every kind;
2. Interest was paid by a resident of the Philippines;
3. The recipient of interest is a resident of Denmark; and
4. The recipient is the beneficial owner of the interest paid.

Anent the *first requirement*, it is never disputed that the subject income constitutes interest, as defined in the afore-quoted paragraph 4 of Article 11 of the RP-Denmark Tax Treaty. In fact, said income is precisely being assessed by respondent as such.

As regards the *second and third requirements*, the residency of petitioner is likewise not being questioned in this case. Notably, the parties' Joint Stipulation of Facts and Issues provides as follows:

"1. Petitioner is a domestic corporation, with principal office at Lot 5 Boton Light and Science Park, Argonaut Highway, Boton Area, SBFZ. xxx

2. Petitioner is a corporation duly registered with the Securities and Exchange Commission ('SEC') under

SEC registration No. A200108178 dated 08 June 2001, xxx.[37]

xxx xxx xxx

5. During the course of its business operations, the Petitioner contracted a loan on 20 December 2007 with SØHOLT HOVEDGÅRD A/S ('SH'), a company incorporated in, and a tax resident of Denmark. Pursuant thereto, interest amounting to P7,667.832.00 was paid by petitioner to SH in 2007." [38] *(Emphasis supplied).*

The afore-quoted stipulations, having been made by the parties in a stipulation of facts during pre-trial, are treated as judicial admissions. Under Section 4, Rule 129 of the Revised Rules of Court, a judicial admission requires no proof. The Court cannot lightly set it aside, especially when the opposing party relies upon it and accordingly dispenses with further proof of the fact already admitted.[39]

Accordingly, petitioner qualifies as a "resident of the Philippines" within the meaning of the tax treaty provisions because, as a *"domestic corporation"*, petitioner is liable to tax in the Philippines under Section 27 of the NIRC of 1997, as amended; while SH qualifies as a "resident of Denmark", for purposes of the tax treaty, simply because the parties have already stipulated that SH is *"a company incorporated in and a **tax resident** of Denmark"*[40].

Verily, compliance with the *second and third requirements* have been established in this case.

As for the *fourth requirement*, the RP-Denmark Tax Treaty requires that the recipient of the interest must be its beneficial owner. While the treaty did not provide a definition of "beneficial owner" or "beneficial ownership", the term must be properly understood in its plain and ordinary meaning.[41]

---

[37] Docket, (Vol. I), p. 215.
[38] Docket, (Vol. I), p. 216.
[39] *Commissioner of Internal Revenue vs. Petron Corporation,* G.R. No. 185568, March 21, 2012; *Toshiba Information Equipment (Phils.), Inc. vs. Commissioner of Internal Revenue*, G.R. No. 157594, March 9, 2010.
[40] Emphasis supplied.
[41] *Commissioner of Internal Revenue vs. Bank of Philippine Islands*, G.R. No. 147375,June 26, 2006.

Beneficial ownership has been defined as ownership recognized by law and capable of being enforced in the courts at the suit of the beneficial owner. It is usually distinguished from naked ownership, which is the enjoyment of all the benefits and privileges of ownership, as against possession of the bare title to property.[42]

Black's Law Dictionary defines a beneficial owner in three senses: *first*, to one recognized in equity as the owner of something because use and title belong to that person, even though legal title may belong to someone else especially one for whom the property is held in trust (also called "equitable owner"); *second*, to a corporate shareholder who has the power to buy or sell the shares, but who is not registered in the corporation's books as the owner; and *third*, to a person or entity who is entitled to enjoy the rights in a patent, trademark, or copyright even though legal title is vested in someone else.[43]

Consistent with the foregoing definition, a beneficial owner, for purposes of the RP-Denmark Tax Treaty, is one who has the full right to use and enjoy the income received.

In the present case, the Credit Agreement[44] shows that SH is the lone creditor to whom the principal amount of the loan and the accumulated interest are directly payable. As the absolute owner of the interest, SH necessarily has the full right to use, enjoy and benefit from the interest paid.

From the foregoing, there is clearly no reason to deprive petitioner of the benefit of the preferential tax rate of 10% on interest in accordance with the RP-Denmark Tax Treaty.

The burden of proof is upon him who claims the exemption in his favor and he must be able to justify his claim by the clearest grant of organic or statute law.[45] In this case, We find that petitioner satisfactorily discharged that burden.

Having established that the 10% preferential tax rate on interest under the RP-Denmark Tax Treaty is applicable, petitioner should not

---

[42] *La Bugal-B'laan Tribal Association vs. Ramos,* G.R. No. 127882, December 1, 2004;
[43] 8th edition, p. 1137.
[44] Exhibit "H".
[45] *Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc.,* G.R. No. 127105, June 25, 1999.

0000000322

be held liable to pay the total deficiency FWT for taxable year 2007 in the amount of ₱ 1,438,549.22.

WHEREFORE, all the foregoing considered, the instant Petition for Review is hereby **GRANTED**. Respondent's deficiency final withholding tax assessment against petitioner for taxable year 2007 in the aggregate amount of ₱ 1,438,549.22, including increments, is hereby **CANCELLED** and **SET ASIDE**.

SO ORDERED.

ERLINDA P. UY
Associate Justice

WE CONCUR:

ROMAN G. DEL ROSARIO
Presiding Justice

(On Wellness Leave)
CIELITO N. MINDARO-GRULLA
Associate Justice

C E R T I F I C A T I O N

Pursuant to Article VIII, Section 13 of the Constitution, 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's Division.

ROMAN G. DEL ROSARIO
Presiding Justice
Chairperson, 1st Division