REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

SECOND DIVISION

WRIGLEY PHILIPPINES, INC., Petitioner,	**C.T.A. CASE NO. 7138**
	Members:
- versus -	**CASTAÑEDA, JR.,** *Chairperson* **UY,** *and* **PALANCA-ENRIQUEZ,** *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	**Promulgated:** JUL 2 6 2007

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DECISION

UY, J.:

This case involves the claim filed by petitioner Wrigley Philippines, Incorporated against respondent Commissioner of Internal Revenue for refund or issuance of a tax credit certificate allegedly representing overpaid withholding taxes for the calendar year 2003 in the total amount of **FOUR MILLION EIGHT HUNDRED FIFTY TWO THOUSAND FOUR HUNDRED SIXTY NINE AND 10/100 PESOS (P4,852,469.10)** .

THE FACTS

As culled from the records, the facts are as follows:

Petitioner is a corporation duly organized and existing under and by virtue of the laws of the Philippines, engaged in the business of manufacturing, purchasing, exporting, importing, selling, and in general, trading and dealing in and handling chewing gum, confectionary, gum chicle, food products, and by-products of any of the foregoing, with principal office at Marcos Highway, Sitio Pulang Bato, Barangay Inarawan, Antipolo City. It is registered as a value added tax (VAT) entity with TIN/VAT No. 000-280-753-000 in accordance with the National Internal Revenue Code (NIRC), as amended, and was issued by the Bureau of Internal Revenue (BIR) National Office, BIR Certificate of Registration No. 8RC0000016763 dated January 1, 1996.

On the other hand, respondent is the duly appointed Commissioner of Internal Revenue vested with authority to act as such, including *inter alia*, the power to decide, approve and grant refunds or tax credit erroneously or illegally collected internal revenue taxes, as provided for by law, holding office at the BIR National Office Building, Diliman, Quezon City.

On July 1, 1993, petitioner entered into a License Agreement[1] with Wm. Wrigley Jr. Company (Wrigley-US), a non-resident foreign corporation duly organized and existing under the laws of the State of Delaware, U.S.A. with business address at 410 North Michigan Avenue, Chicago, Illinois, USA for a period of ten (10) years from execution thereof. The License Agreement was renewed on July 1, 2003 for another ten (10) years or until June 30,

[1] Exhibit "A-2", and duly registered with the Bureau of Patents, Trademarks and Technology Transfer (now Intellectual Property Office) on July 23, 1993 (Exhibit "A").

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2013. Under the aforementioned Agreement, Wrigley-US granted to petitioner the following rights:

"1. RIGHTS GRANTED

a. WRIGLEY hereby grants to WRIGLEY PHILIPPINES the License to manufacture and sell chewing gum under the TECHNICAL DATA owned by WRIGLEY.

b. WRIGLEY agrees to keep WRIGLEY PHILIPPINES informed of all developments or improvements relating to the manufacture of chewing gum. For the term of this agreement WRIGLEY PHILIPPINES shall be entitled to use the developments and improvements made by WRIGLEY whether or not such developments or improvements are patented.

c. WRIGLEY shall continue to operate the aforesaid departments and laboratories at its expense and shall render technical assistance to WRIGLEY PHILIPPINES by communicating and interpreting to WRIGLEY PHILIPPINES techniques that may be developed by Wrigley with respect to the marketing, selling, advertising, manufacturing and packaging of chewing gum.

d. WRIGLEY grants WRIGLEY PHILIPPINES the exclusive right to manufacture, use and sell in the Philippines under the trademarks listed in Appendix 'A' which is attached hereto (which trademarks are hereinafter referred to as 'the said trademarks')."[2]

In consideration of the above rights and for the benefits received by petitioner under the License Agreement, petitioner agreed to pay Wrigley-US, in respect of all chewing gum manufactured and sold, a fee of five percent (5%) based on Net Sales plus two percent (2%) based on Net Foreign Exchange Earnings.[3] It was likewise agreed that all Philippine withholding

[2] Ibid, at p. 4.
[3] Id., at p. 5.

taxes on all payments under the Agreement shall be withheld by petitioner and deducted from the payments due to Wrigley-US.[4]

In accordance with the foregoing provisions of the License Agreement dated July 1, 1993, petitioner paid Wrigley-US the royalty fees due thereon for the calendar year 2003 and subjected the same to fifteen percent (15%) withholding tax rate, applying the "most favored nation" clause as embodied in the said treaty, taking into consideration the pertinent provisions of the RP-Russia, RP-Denmark or RP-Sweden tax treaties.

As appearing on petitioner's Monthly Remittance Returns of Final Income Taxes Withheld (BIR Form No. 1601-F) for the period covering January 2003 to December 2003, the following were the remitted final taxes on royalties, computed at fifteen percent (15%) pursuant to the "most favored nation" clause of Article 13(2)(b)(iii) of the RP-US Tax Treaty, to wit:

Calendar Year 2003	Date of Filing	Amount of Royalty Payments	Amount of Withholding Taxes Remitted at 15%
January	7-Feb-03	7,697,741.00	1,154,661.00
February	10-Mar-03	7,276,853.00	1,091,528.00
March	9-Apr-03	6,853,573.00	1,028,036.00
April	8-May-03	7,445,467.00	1,116,820.00
May	10-Jun-03	7,158,073.00	1,073,711.00
June	10-Jul-03	7,133,721.00	1,070,058.00
July	8-Aug-03	8,593,374.00	1,289,006.00
August	9-Sep-03	7,882,697.00	1,182,405.00
September	10-Oct-03	10,336,429.00	1,550,464.00

[4] Paragraph 8(b), Exhibit "A-2".

October	10-Nov-03	7,718,193.00	1,157,729.00
November	9-Dec-03	8,260,688.00	1,239,103.00
December	12-Jan-04	10,692,570.00	1,603,886.00
Total		**97,049,379.00**	**14,557,407.00**

On November 18, 1999, the Agreement between the Government of the Republic of the Philippines and the Government of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, or the RP-China Tax Treaty, was signed and took effect on January 1, 2002. The said Treaty imposed only ten percent (10%) withholding tax rate on royalty payments 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.

Consequently, on February 27, 2003, petitioner filed with the Bureau of Internal Revenue-International Tax Affairs Division (BIR-ITAD), a request for confirmation of whether petitioner's royalty payments to Wrigley-US are subject to ten percent (10%) withholding tax rate pursuant to the provisions of Article 13(2)(b)(iii) or the "most favored nation" clause of the RP-US Tax Treaty in relation to Article 12(2)(b) of the RP-China Tax Treaty with a Claim for Refund or Issuance of a Tax Credit Certificate.

In response to petitioner's request, the BIR-ITAD, through its Assistant Commissioner, Milagros V. Regalado, issued on September 23, 2003, BIR Ruling No. DA-ITAD-142-03 which ruled, among others, that:

> "Such being the case, this Office is of the opinion and so holds that the royalty payments of WPI to Wrigley-US under the License Agreement are subject to final withholding tax at the rate of 10% pursuant to the 'most favored nation' provision of the RP-US tax treaty in relation to the RP-China tax treaty effective January 1, 2002 [Revenue Memorandum Circular (RMC) No. 46-2002 dated September 2, 2002; BIR Ruling No. DA-ITAD 101-03 dated July 24, 2003]. WPI shall deduct and withhold the tax at the time the royalty income payment is paid or payable, or the income payment is accrued or recorded as an expense or asset, whichever is applicable, and whichever comes first. The term 'payable' refers to the date the obligation become due, demandable, or legally enforceable [Section 4-Time of Withholding, Revenue Regulations No. 12-2001]."[5]

However, in the same ruling, petitioner's claim for refund or issuance of a tax credit certificate was resolved in this manner:

> "This ruling is issued on the basis of the facts as presented and is rendered only for the purpose of determining whether Wrigley is entitled to the benefits of the RP-US Tax Treaty. The determination on whether your request for tax refund should be given due course is upon the Office which will be conducting the investigation for that purpose. Thus, the docket pertaining thereto (including copy of this ruling) shall be endorsed to the proper office for processing and investigation."[6]

On the basis of the above ruling, petitioner filed on November 9, 2004 a formal claim for refund or issuance of a tax credit certificate with the Large Taxpayers Audit and Investigation Division I of the Bureau of Internal Revenue for its alleged overpaid withholding taxes paid for the calendar year 2003 in the amount of P4,852,469.10.[7] Having received no response from respondent, and before it could be barred by prescription, petitioner then filed the instant Petition for Review on February 4, 2005.

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[5] Exhibit "F", DA-ITAD Ruling No. 142-03, Bureau of Internal Revenue, Quezon City, p. 3.
[6] Ibid, at p. 4.
[7] Paragraph 9, Joint Stipulations of Facts and Issues.

On April 5, 2005, respondent filed his Answer, raising the following as his Special and Affirmative Defenses:

> "4. Petitioner's alleged claim for refund is subject to administrative routinary investigation/examination by the Bureau;
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> 5. The amount of P4,852,469.10 being claimed by petitioner as alleged overpaid withholding taxes for calendar year 2003 was not properly documented;
>
> 6. In an action for refund, the burden of proof is on the taxpayer to establish its right to refund, and failure to sustain the burden is fatal to the claim for refund/credit;
>
> 7. Petitioner must show that it has complied with the provisions of Section 204 (C) and 229 of the Tax Code on the prescriptive period for claiming tax refund/credit;
>
> 8. Claims for refund are construed strictly against the claimant for the same partake the nature of exemption from taxation (*Commissioner of Internal Revenue vs. Ledesma, 31 SCRA 95*) and as such, they are looked upon with disfavor (*Western Minolco Corp. vs. Commissioner of Internal Revenue, 124 SCRA 1211*)."[8]

The issues having been joined, pre-trial ensued and both parties entered into a Joint Stipulation of Facts and Issues which they submitted on May 26, 2005 and correspondingly approved on June 9, 2005.[9] During trial, only petitioner presented its evidence while respondent's counsel manifested during the hearing held on November 6, 2006 that she would not be presenting evidence. Thus, the parties were directed to file their respective memoranda. Only petitioner filed its Memorandum[10] on November 24, 2006 and this case was considered submitted for decision on February 2, 2007.

Hence, this Decision.

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[8] Answer, Records, pp. 139-143.
[9] Joint Stipulation of Facts and Issues, Records, pp. 169-178; Resolution dated June 9, 2005 Records, p. 190.
[10] Memorandum for Petitioner , Records, pp. 388-413.

THE ISSUES

The parties mutually agreed on the following issues for the resolution of this Court:

1. Whether or not petitioner had met the two requirements for the availment of the preferential tax rate of ten percent (10%) on royalty payments to a resident of the US pursuant to the "most favored nation clause" of the Philippines-US Tax Treaty in relation to the Philippines-China Tax Treaty for the calendar year 2002, i.e. (1) there is an agreement or contract whereby the royalties paid to the US must originate from the use of, or the right to use any patent, trade mark, design or model, plan, secret formula or process, or from the use, or the right to use, industrial, commercial or scientific experience; and (2) for as long as the contract or agreement is subject to approval under Philippine law, the same must be duly approved by the Philippine competent authorities;

2. Whether or not petitioner paid Wrigley-US the fees due under the License Agreement dated July 1, 1993, for the calendar year 2003, and correspondingly withheld and remitted to the BIR the fifteen percent (15%) withholding tax on said fees based on the "most favored nation clause" in the Philippines-US Tax Treaty, in relation to the pertinent provisions of the Philippines-Russia, Philippines-Denmark or Philippines-Sweden Tax Treaties;

3. Whether or not petitioner had timely and duly filed the administrative claim for the refund or issuance of a tax credit certificate for overpaid withholding taxes for calendar year 2003 amounting to P4,852,469.10; and

4. Whether or not petitioner is entitled to a tax refund or a tax credit certificate in the amount of Four Million Eight Hundred Fifty Two Thousand Four Hundred Sixty Nine Pesos and 10/100 (P4,852,469.10), representing overpaid withholding income taxes for calendar year 2003.

THE COURT'S RULING

We shall first discuss the issue pertaining to prescription.

Pursuant to Section 229 of the National Internal Revenue Code (NIRC) of 1997, no suit or proceeding in Court for the refund of erroneously or illegally assessed or collected national revenue taxes shall be filed after the expiration of two (2) years from the date of payment of the tax or penalty regardless of any supervening cause that may arise after payment. Thus, petitioner has a period of two (2) years from the date of its payment or remittance of the subject withholding tax within which to file its claim for refund or issuance of a tax credit certificate.

Records reveal that petitioner remitted its payment for the final taxes on the royalties due to Wrigley-US for the period covering January to December 2003, as follows:

Calendar Year 2003	**Date of Filing**
January	07-Feb -03
February	10-Mar -03
March	09- Apr -03
April	08-May-03
May	10-Jun -03
June	10- Jul -03
July	08-Aug -03
August	09-Sep -03
September	10-Oct -03
October	10-Nov -03
November	09-Dec -03
December	12-Jan - 04

Thus, based on the aforementioned remittance dates, petitioner, at the earliest, had until February 7, 2005 to file both its administrative and judicial claims for refund. Petitioner filed its administrative claim for refund on November 9, 2004 (as stipulated by the parties) and the instant petition for review on February 4, 2005, both of which are well within the two-year prescriptive period.

We now proceed to the main issues in this case.

The core of the controversy is the proper interpretation of the provisions of the RP-US, RP-Russia, RP-Denmark or RP-Sweden and RP-China Tax Treaties, particularly, the provisions on the rate of final taxes on royalties to be imposed by the Philippines upon royalties received by a non-resident foreign corporation. For a better understanding of the provisions of the aforementioned tax treaties, the pertinent articles and provisions are hereunder quoted:

RP-US TAX TREATY

"Article 13
Royalties

(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) **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.**

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(3) The term 'royalties' as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematographic film or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process or other like right or property, or for information concerning industrial, commercial or scientific experience. The term 'royalties' also includes gains derived from the sale, exchange or other disposition of any such right or property which are contingent on the productivity, use or disposition thereof." (*Emphasis supplied*)

RP-RUSSIA TAX TREATY

"Article 12
Royalties

1. Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, the royalties may also be taxed in the Contracting State in which they arise and according to the laws of the State, but the tax so charged **shall not exceed 15 per cent of the gross amount of royalties.**

3. The term 'royalties' as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films and films and tapes for television or radio broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience." (*Emphasis supplied*)

RP-DENMARK TAX TREATY

"Article VIII
Royalties

(1) Royalty paid by a resident or corporation of the Philippines to a resident or corporation of Denmark may be taxed in the Philippines.

(2) In this Article, the term 'royalty' means any royalty or amount paid as consideration for the use of, or for the privilege of using any copyright, patent, design, secret process or formula, trademark, or the like property, and other amount paid in respect of the operation of a mine or quarry or of any other extraction of natural resources.

(3) The Philippine withholding tax on royalty paid to a resident or corporation in Denmark by a resident or corporation in the Philippines may be reduced by 1/3 of the regular tax due thereon if:

(a) The payor is engaged in the active conduct of business in area of investment enumerated in paragraph 2 of Article VI, preferably in joint venture; and

(b) eighty per cent (80%) of the gross income of the payor during the taxable year was derived from the active conduct of business in preferred areas of investment where the subject royalty payment was utilized."

<u>RP-CHINA TAX TREATY</u>

"Article 12
Royalties

1. Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of the State, but if the recipient is the beneficial owner of the royalties, the tax so charged shall not exceed:

a) 15 per cent of the gross amount of royalties arising from the use of, the right to use, any copyright of literary, artistic or scientific work including cinematograph films or tapes for television or broadcasting, or

b) **10 per cent of the gross amount of royalties arising from the use of, or the right to use, any patent, trade mark,**

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 if the contract giving rise to such royalties has been approved by the Philippine competent authorities.

3. The term 'royalties' as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience." (*Emphasis supplied*)

As regards the first issue, petitioner submits that it had satisfied legal requirements for the availment of the preferential tax rate of ten percent (10%) on royalty payments to a resident of the US pursuant to the "most favored nation clause" of the Philippines-US Tax Treaty, in relation to the Philippines-China Tax Treaty for the calendar year 2003.

Under Revenue Memorandum Circular (RMC) No. 46-02, the following conditions must be complied with before the reduced withholding tax rate of ten percent (10%) on royalties may be availed of by the taxpayer invoking the same, thus:

1. It is necessary that there be an agreement or a contract whereby the royalties paid to the US must originate from the use of, or the right to use any patent, trade mark, design or model, plan, secret formula or process, or from the use, or

the right to use, industrial, commercial or scientific experience; and

2. For as long as the contract or agreement is subject to the approval under Philippine law, the same must be duly approved by the Philippine competent authorities.

To prove compliance with the foregoing requisites, petitioner presented the following documentary evidence, to wit:

1. Certificate of Registration No. 1466 issued by the Bureau of Patents, Trademarks and Technology Transfer dated July 23, 1993;[11]

2. License Agreement entered into by and between the petitioner and Wrigley-US, duly authenticated by the Consulate General of the Philippines at Chicago, Illinois on July 6, 1993;[12]

3. Renewal Agreement between petitioner and Wrigley-US for the renewal of the original License Agreement for a period of ten (10) years, duly authenticated by the Consulate General of the Philippines at Chicago, Illinois on September 5, 2003;[13] and

4. Certificate of Compliance No. 5-2003-00062 issued by the Intellectual Property Office on September 23, 2003.[14]

Based on the foregoing documents, this Court is convinced that petitioner is entitled to the reduced withholding tax rate of ten percent (10%) on its royalty payments. Clearly, petitioner entered into a License Agreement with Wm. Wrigley Jr. Company (or Wrigley-US), a corporation organized and existing under the laws of the State of Delaware wherein the former agreed to pay the latter, royalty or license fees, for its use of the "formulae, written descriptions, blue prints, manufacturing processes, inventions and methods with respect to the manufacture of chewing gum" (referred to as Technical

[11] Exhibit "A".
[12] Exhibit "A-1".
[13] Exhibits "B-1" and "B-2".
[14] Exhibit "B".

Data in the agreement). The Court also notes that this License Agreement was duly registered and approved by Philippine competent authorities as shown by the Certificate of Registration No. 1466 issued by the Bureau of Patents, Trademarks and Technology Transfer of the Department of Trade and Industry, as well as the Certificates of Compliance issued by the Intellectual Property Office which duly confirmed the compliance of the subject Royalty Agreement with the provisions of R.A. No. 8293 (Intellectual Property Code) on Voluntary Licensing.

It appearing therefore that petitioner has duly complied with the legal requirements for its availment of the preferential tax rate of ten percent (10%) on its royalty payments to Wrigley-US, We shall determine whether petitioner's claim will prosper.

Petitioner submits that pursuant to the pertinent provisions of the RP-US Tax Treaty, in relation to the provisions of the RP-Russia, RP-Denmark or RP-Sweden Tax Treaties, it had in fact withheld and remitted to the BIR, the corresponding concessional tax rate of fifteen percent (15%) on its royalty payments to Wrigley-US of P97,042,709.00, or in the amount of P14,556,407.00 for the taxable year 2003. Considering the effectivity of the provisions of the RP-China Tax Treaty regarding taxes on income and the "most favored nation clause" found in Article 13(2)(b)(iii) of the RP-US Tax Treaty, petitioner contends that it is now entitled to the lowest tax rate of Philippine tax that may be imposed on royalties of the same kind and paid under similar circumstances to a resident of a third State, which is at the rate of ten percent (10%). To bolster its claim, petitioner offered in evidence BIR-

ITAD Ruling No. DA-ITAD-142-03 which confirmed its opinion that, pursuant to the provisions on taxes on income under the RP-China Tax Treaty, petitioner's royalty payments accruing and/or paid beginning January 1, 2002, shall be taxed at the final withholding tax rate of ten percent (10%).

We find merit in petitioner's contention.

It must be emphasized that the RP-US, RP-Russia, RP-Denmark, RP-Sweden and RP-China Tax Treaties are just a few of the bilateral agreements which the Philippines has entered into, for the purpose of avoiding, if not eliminating, double taxation and its effects on the national fiscal legislations of the contracting parties. Double taxation usually takes place when a person is a resident of a contracting state and derives income from, or owns capital in, the other contracting state and both states impose tax on that income or capital. More precisely, the tax conventions are drafted with 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.[15] For these purposes, treaties or agreements on the subject matters entered into then provide for several methods of avoiding from or eliminating double taxations' destructive effects on the free flow of goods and services, as well, as in the movement of capital, technology and persons.

In the instant case, both the Philippines, as the state of source, and the United States, as the state of residence, are permitted to tax the royalties paid by petitioner for the right to use Wrigley-US's secret technical data, formulae,

[15] Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc., 309 SCRA 87 (1999).

inventions and other confidential know-how relating to or in connection with the manufacture of chewing gum. This, undoubtedly, is a case of double taxation. Under the RP-US Tax Treaty, the allowance of a tax credit to citizens or residents of the United States (in an appropriate amount based upon the taxes paid or accrued to the Philippines) against the United States tax, which such tax shall not exceed the limitations provided by United States law for the taxable year, is allowed to give relief from double taxation.

On the other hand, under Article 13 thereof, the Philippines is given the choice from three rates, namely: twenty five percent (25%) of the gross amount of royalties; fifteen percent (15%) when the royalties are paid by a corporation registered with the Philippine Board of Investment and engaged in preferred areas of activities; or the lowest rate of Philippine tax that may be imposed on royalties of the same kind paid under similar circumstances to a resident of the third State. The phrase "**paid under similar circumstances**" under the "**most favored nation clause**" has been construed as referring to the manner of payment of taxes or "circumstances which are tax-related", and not to the subject matter of the tax.

In the leading case of **Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc.**,[16] the Supreme Court interpreted the "most favored nation clause", particularly the phrase "paid under similar circumstances", as referring to the manner of payment of tax, and not to the subject matter of the tax, which is "royalties", thus:

> **"The purpose of a most favored nation clause is to grant to the contracting party the treatment not less favorable**

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[16] Ibid.

> **than that which has been or may be granted to the 'most favored' among other countries. The most favored nation clause is intended to establish the principle of equality of international treatment by providing that the citizens or subjects of the contracting nations may enjoy the privileges accorded by either party to those of the most favored nation. The essence of the principle is to allow the taxpayer in one state to avail of more liberal provisions granted in another tax treaty to which the country of residence of such taxpayer is also a party provided that the subject matter of taxation, in this case royalty income, is the same as that in the tax treaty under which the taxpayer is liable. Both Article 13 of the RP-US Tax Treaty and Article 12 (2)(b) of the RP-West Germany Tax Treaty, above-quoted, speaks of tax on royalties for the use of trademark, patent and technology.** The entitlement of the 10% rate by U.S. firms despite the absence of a matching credit (20% on royalties) would derogate from the design behind the most favored nation clause to grant equality of international treatment since the tax burden laid upon the income of the investor is not the same in the two countries. **The similarity in the circumstances of payment of taxes is a condition for the enjoyment of most favored nation treatment precisely to underscore the need for equality of treatment.**" (*Emphasis supplied*)

This being so, the provisions of the RP-US, RP-Russia, and RP-China Tax Treaties pertaining to royalties should then be read together with the provisions on the Avoidance or Relief from Double Taxation. Pertinent provisions of the three treaties are quoted hereunder for easy reference, to wit:

<u>RP-US TAX TREATY</u>

"Article 23
Relief from double taxation

Double taxation of income shall be avoided in the following manner:

1. In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a citizen

or resident of the United States as a credit against the United States tax the appropriate amount of taxes paid or accrued to the Philippines and, in the case of a United States corporation owning at least 10 percent of the voting stock of a Philippine corporation from which it receives dividends in any taxable year, shall allow credit for the appropriate amount of taxes paid or accrued to the Philippines by the Philippine corporation paying such dividends with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of tax paid or accrued to the Philippines, but the credit shall not exceed the limitations (for the purpose limiting the credit to the United States tax on income from sources within the Philippines or on income from sources outside the United States) provided by United States law for the taxable year. For the purpose of applying the United States credit in relation to taxes paid or accrued to the Philippines, the rules set forth in Article 4 (Source of Income) shall be applied to determine the source of income. For purposes of applying the United States credit in relation to taxes paid or accrued to the Philippines, the taxes referred to in paragraphs (1)(b) and (2) of Article 1 (Taxes Covered) shall be considered to be income taxes.

2. In accordance with the provisions and subject to the limitations of the law of the Philippines (as it may be amended from time to time without changing the general principle hereof), the Philippines shall allow to a citizen or resident of the Philippines as a credit against the Philippine tax the appropriate amount of taxes paid or accrued to the United States and, in the case of a Philippine corporation owning more than 50 percent of the voting stock of a United States corporation from which it receives dividends in any taxable year, shall allow credit for the appropriate amount of taxes paid or accrued to the United States by the United States corporation paying such dividends with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of tax paid or accrued to the United States, but the credit shall not exceed the limitations (for the purpose of limiting the credit to the Philippine tax on income from sources within the United States and on income from sources outside the Philippines) provided by Philippines law for the taxable year. For the purpose of applying the Philippines credit in relation to taxes paid or accrued to the United States, the rules set forth in Article 4 (Source of Income) shall be

applied to determine the source of income. For purposes of applying the Philippine credit in relation to taxes paid or accrued to the United States, the taxes referred to in paragraphs (1)(a) and (2) of Article 1 (Taxes Covered) shall be considered to be income taxes."

RP-RUSSIA TAX TREATY

"Article 23
Relief from Double Taxation

In the case of the Philippines, double taxation shall be avoided in the following manner:

Subject to the provisions of the laws of the Philippines relating to the allowance as credit against Philippine tax of tax payable in any country other than the Philippines, income taxes paid or have accrued under the laws of the Russian Federation and in accordance with this Convention, whether directly or by deduction, in respect of income from sources within the Russian Federation shall be allowed as a credit against Philippines tax payable in respect of that income.

In the case of a Philippine corporation owning more than 50 per cent of the voting stock of a Russian company from which it receives dividends in any taxable year, the Philippines shall also allow credit for the appropriate amount of taxes paid or accrued in the Russian Federation to a Russian company paying such dividends with respect to the profits out of which such dividends are paid. The deduction shall not, however, exceed that part of the Philippine income tax, as computed before the deduction is given, which is appropriate to the income which may be taxed in the Russian Federation;

In the case of the Russian Federation, double taxation shall be avoided in the following manner:

Where a resident of the Russian Federation derives income from the Philippines, the amount of tax of that income payable in the Philippines in accordance with the provisions of this Convention, may be credited against the tax levied in the Russian Federation imposed on that resident. The amount of credit, however, shall not exceed the amount of the Russian tax on that income computed in accordance with taxation laws and regulations of the Russian Federation."

RP-CHINA TAX TREATY

"Article 23
Methods for the Elimination of Double Taxation

1. In the Philippines, double taxation shall be eliminated as follows:

   Subject to the laws of the Philippines and the limitations thereof regarding the allowance of a credit against Philippine tax of tax payable in any country other than the Philippines. Chinese tax payable in respect of income derived from China shall be allowed as credit against the Philippine tax payable in respect of that income.

2. In China, double taxation shall be eliminated as follows:

   Where a resident of China derives income from the Philippines the amount of tax on that income payable in the Philippines in accordance with the provisions of this Agreement, may be credited against the Chinese tax imposed on that resident. The amount of the credit, however, shall not exceed the amount of the Chinese tax on that income computed in accordance with the taxation laws and regulations of China."

Verily, based on the foregoing, the concessional rates of fifteen percent (15%) and ten percent (10%) as provided under the RP-Russia and RP-China Tax Treaties, respectively, should apply only if the taxes imposed upon royalties in the RP-US Tax Treaty, RP-Russia Tax Treaty, and RP-China Tax Treaty are paid under similar circumstances. Under Article 23 (1) and (2) on Relief from Double Taxation of the RP-US Tax Treaty, it is provided that the allowable foreign tax credit under the treaties is the appropriate amount of taxes actually paid or accrued to the Philippines. Although various tax treaties already in force would show dissimilar provisions on the relief from or avoidance of double taxation as this is a matter of negotiations between the contracting states, a cursory reading of the RP-Russia and RP-China Tax

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Treaties reveals similar provisions on the relief from or avoidance of double taxation as those stipulated in the RP-US Tax Treaty, which provision is not found in the RP-West Germany Tax Treaty. In other words, the three treaties deal with the method of payment by allowing a credit of the foreign tax as against the taxes actually paid in the Philippines, which is considered as paid under similar circumstances.

As earlier discussed, the purpose of the "most favored nation" clause is to grant to the contracting state treatment not less favorable than that which has been or may be granted to the "most favored" among other countries. And this is definitely intended to establish the principle of equality of international treatment by providing that the citizens or subjects of the contracting nations may enjoy the privileges accorded by either party to those of the "most favored nation".[17]

Moreover, this finds support in BIR Ruling DA-ITAD No. 142-03 issued by the International Tax Affairs Division of the BIR, through its Assistant Commissioner for Legal Service, Milagros V. Regalado on September 23, 2003, which provides in part:

> "In the case of Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc. and Court of Appeals, G.R.N. 127105, promulgated on June 25, 1999, the Supreme Court interpreted the 'most-favored-nation' clause, particularly the phrase 'paid under similar circumstances', as referring to the manner of payment of taxes and not to the subject matter of the tax which is royalties. (BIR Ruling No. ITAD 118-01 dated February 23, 2001 and BIR Ruling ITAD 109-02 dated May 30, 2002).
>
> Such being the case, this Office is of the opinion and so holds that the royalty payments of WPI to Wrigley-US under the

[17] Id.

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> License Agreement are subject to final withholding tax at the rate of 10% pursuant to the 'most favored nation' provision of the RP-US tax treaty in relation to the RP-China tax treaty effective January 1, 2002. [Revenue Memorandum Circular(RMC) No. 46-2002 dated September 2, 2002; BIR Ruling No. DA-ITAD 101-03 dated July 24, 2003] WPI shall deduct and withhold the tax at the time the royalty income payment is paid or payable, or the income payment is accrued or recorded as an expense or asset, whichever is applicable, and whichever comes first. The term 'payable' refers to the date the obligation become due, demandable or legally enforceable [Section 4-Time of Withholding, Revenue Regulations No. 12-2001]."

Clearly then, the provisions of the RP-China Tax Treaty, more particularly, the reduced tax rate on royalties at ten percent (10%) should apply to petitioner.

With regard now to the amount of the alleged overpayment claimed, petitioner submits that it actually withheld and remitted the total amount of P14,557,407.00 (P97,049,379.00 x 15%) for the taxable year 2003 as withholding taxes on its royalty payments to Wrigley-US, which amount is based on the concessional rate of fifteen percent (15%), per its Monthly Remittance Returns. However, pursuant to the provisions of the RP-US and RP-China tax treaties, it should only withhold and remit the amount of P9,704,937.90 (P97,049,379.00 x 10%) based on the concessional tax rate of ten percent (10%).

Relative thereto, the Court found the following documentary evidence supportive of petitioner's subject claim, to wit: Monthly Remittance Returns for the taxable year 2003, Annual Income Tax Return, with the related Journal Vouchers,[18] Schedules showing Intercompany Fee Details, and the testimony

[18] Exhibits "W", "X", "Y", "Z", "AA", "BB", "CC", "DD", "EE", "FF", "GG", "HH" and "II".

of its witnesses, but in the reduced amount of P4,852,136.10. Based on the applicable concessional tax rate of ten percent (10%), petitioner only owes the Government of the Philippines the final taxes on royalty in the amount of P9,704,270.90 pursuant to the RP-China Tax Treaty. Consequently, petitioner made an overpayment of P4,852,469.10 (P14,557,407.00 – P9,704,937.90), detailed as follows:

Calendar Year 2003	Date of Filing	Amt of Royalty Payments	Amt of Withholding Taxes Remitted at 15%	Amount of Withholding Taxes at 10% Tax rate	Overpaid Withholding Taxes
January	7-Feb-03	7,697,741.00	1,154,661.00	769,774.10	384,886.90
February	10-Mar-03	7,276,853.00	1,091,528.00	727,685.30	363,842.70
March	9-Apr-03	6,853,573.00	1,028,036.00	685,357.30	342,678.70
April	8-May-03	7,445,467.00	1,116,820.00	744,546.70	372,273.30
May	10-Jun-03	7,158,073.00	1,073,711.00	715,807.30	357,903.70
June	10-Jul-03	7,133,721.00	1,070,058.00	713,372.10	356,685.90
July	8-Aug-03	8,593,374.00	1,289,006.00	859,337.40	429,668.60
August	9-Sep-03	7,882,697.00	1,182,405.00	788,269.70	394,135.30
September	10-Oct-03	10,336,429.00	1,550,464.00	1,033,642.90	516,821.10
October	10-Nov-03	7,718,193.00	1,157,729.00	771,819.30	385,909.70
November	9-Dec-03	8,260,688.00	1,239,103.00	826,068.80	413,034.20
December	12-Jan-04	10,692,570.00	1,603,886.00	1,069,257.00	534,629.00
Total		97,049,379.00	14,557,407.00	9,704,937.90	**4,852,469.10**

WHEREFORE, premises considered, the subject Petition for Review is hereby **GRANTED**. Accordingly, respondent is **ORDERED TO REFUND** or in the alternative, **TO ISSUE A TAX CREDIT CERTIFICATE** in favor of petitioner in the amount of **FOUR MILLION EIGHT HUNDRED FIFTY TWO THOUSAND FOUR HUNDRED SIXTY NINE AND 10/100 PESOS**

(P4,852,469.10) representing petitioner's overpayment of final taxes on royalties withheld for the period covering the taxable year 2003.

SO ORDERED.

ERLINDA P. UY
Associate Justice

WE CONCUR:

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

ATTESTATION

I attest 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.

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairperson

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Justice