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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

UNISYS AUSTRALIA LIMITED
(PHILIPPINE BRANCH)
Petitioner,

- versus -

C.T.A. CASE NO. 5151

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
JUN 24 1997

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D E C I S I O N

This is a petition seeking for the refund of P2,182,391.40 alleged to be overpaid withholding taxes on royalties paid by the petitioner for the period October 1, 1991 to June 30, 1993.

Petitioner is a foreign corporation duly licensed to do business in the Philippines. It entered into an EDP SOFTWARE AND TECHNICAL INFORMATION LICENSE AGREEMENT with UNISYS CORPORATION, a corporation duly organized and existing under the laws of the State of Michigan, U.S.A., concerning the use and sub-licensing of software (Exh. A-1, pp. 80-94, CTA rec.).

The said License Agreement was duly registered and approved by the Bureau of Patents, Trademark and Technology Transfer (BPTTT) on April 25, 1991 and was valid for a period of five (5) years from June 1, 1990 to May 31, 1995 (Exhs. A, p.78, CTA rec., and A-2, p. 79, CTA rec.).

Under this License Agreement, petitioner is obliged to pay UNISYS CORPORATION royalty equivalent to thirty five (35%) percent of net sales of programs reproduced and sold (TSN, June 7, 1995 Hearing, p. 10; Exh. A-2, supra).

This License Agreement was preterminated on March 15, 1993 through an "Agreement to Pre-terminate the EDP Software and Technical Information License Agreement" entered into between the petitioner and UNISYS CORPORATION (Exh. B, pp. 96-98, CTA rec.). A new agreement was entered into by the parties called the "EDP Software and Technical Information Renewal License Agreement" which increased the royalty rate to 50% effective March 15, 1993. (Exh. C, pp. 99-110, CTA rec.). The renewed License Agreement was likewise registered and approved by the BPTTT (Exh. D, p. 111, CTA rec.).

In compliance with the respondent's Revenue Memorandum Circular No. 39-92 (Exh. J, p. 117, CTA rec.), petitioner withheld the following amount of taxes equivalent to twenty five percent (25%) of the royalties due to UNISYS CORPORATION on the dates specified below:

Period Covered	Royalty Payable	25% Tax Withheld	Date Remitted to the BIR
10-01-91 to 12-31-91	P 4,204,730.00	P 420,473.00	07-10-92
		210,236.00	09-23-92
		420,473.00	10-16-92
01-01-92 to 03-31-92	1,923,485.00	192,349.00	07-10-92
		96,174.00	09-23-92
		192,349.00	10-16-92
04-01-92 to 06-30-92	793,061.00	198,265.00	10-16-92
07-01-92 to 09-30-92	2,495,545.00	623,886.00	10-16-92
10-01-92 to 12-31-92	756,777.00	189,181.00	03-10-93
01-01-93 to 06-30-93	4,375,678.00	1,093,918.00	11-10-93
Total	P14,549,276.00	P3,637,304.00	

On April 22, 1993 and January 26, 1994, petitioner filed written claims for refund with the respondent alleging that it had erroneously remitted taxes withheld on royalties paid to UNISYS CORPORATION in the amount of P1,412,523,15 and P769,868,25, respectively, for the period October 1, 1991 to June 30, 1993. Petitioner argued that the tax withheld should only be 10% instead of 25% actually withheld and remitted to the Bureau of Internal Revenue. In line with the rulings issued by the Bureau of Internal Revenue and the various decisions of this Court in cases involving the 10% preferential tax rate of the "most favored nation's clause" of the RP-US Tax Treaty.

Considering that the two-year period mandated by law under Sections 204 and 230 of the Tax Code is about to expire, the inaction of the respondent on the aforementioned claims prompted the petitioner to file the instant petition before this Court on September 22, 1994.

Petitioner alleged that under the so-called "most favored nation" provision found in Article 13(2)(b)(iii) of the RP-US Tax Treaty, the tax imposable on royalties derived by a resident of the United States of America 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. It further maintains that under Article 12(2)(b) of the RP-West Germany Tax Treaty, the royalties arising in the Philippines and paid to a resident of West Germany may be taxed in the Philippines, but the tax so charged shall not exceed 10% of the gross amount of royalties arising from the use of 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.

Respondent for her part alleged that in order that the "most favored nation" clause under the RP-US Tax Treaty may be availed of in relation to the RP-West Germany Tax Treaty, the tax on royalties must be paid under similar circumstances obtaining in the latter treaty. Respondent, cited Article 24(1)(b)(dd) and (c)(cc) of the RP-West Germany Tax Treaty, to wit:

"Article 24

Relief from Double Taxation

1. Tax shall be determined in the case of a resident of the Federal Republic of Germany as follows:

xxx xxx xxx

(b) Subject to the provisions of German tax laws regarding credit for foreign tax, there shall be allowed as a credit against German income and corporation tax payable in respect of the following items of income arising in the Republic of the Philippines, the tax paid under the laws of the Philippines and in accordance with this Agreement on:

xxx xxx xxx

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

xxx xxx xxx

(c) For the purpose of credit referred to in subparagraph (b) the Philippine tax shall be deemed to be:

xxx xxx xxx

(cc) in the case of royalties for which the tax is reduced to 10 or 15 per cent according to paragraph 2 of Article 12, 20% of the gross amount of such royalties." (Underscoring supplied)

where she based her theory that the tax on royalties under the RP-US Tax Treaty is not paid under similar circumstances obtaining in the RP-West Germany Tax Treaty, absent the "matching credit" provided in the latter treaty.

The primodial issue raised by both parties in this case is whether the tax to be imposed on royalties paid by petitioner to Unisys Corporation should be 10% or 25%.

The foregoing issue had long been settled by this Court in numerous cases which affirmed the ruling pronounced by then Commissioner of Internal Revenue, Bienvenido Tan, in BIR Ruling No. 456-88, where the 10% tax rate is imposed on royalties derived by a resident of the United States from sources within the Philippines pursuant to the "most favored nation" provision of the RP-US Tax Treaty under Article 12(b)(iii) in relation to Article 12(2)(b) of the RP-West Germany Tax *Treaty* ***(Abbot Laboratories, (Philippines) vs. Commissioner of Internal Revenue, CTA Case No. 5119, September 9, 1996; S.C. Johnson and Son, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 5136, May 7, 199; Armco Marsteel Alloy Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5115, February 6, 1996; Gilette (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 31, 1993; Kimberly-Clark Corporation (U.S.A.) and Kimberly-Clark (Philippines) Inc., vs. Commissioner or Internal Revenue, CTA Case No. 4288, January 30, 1992).

In the case of **S.C. Johnson and Sons, Inc., vs. The Commissioner of Internal Revenue, CTA Case No. 5136, May 7, 1996, citing the case of IBM Philippines Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4308, March 31, 1993,** We ruled that:

> "This Court is of the persuasion that petitioner's stand is correct and concurs with the opinion rendered by the then Commissioner of Internal Revenue, Bienvenido Tan, (BIR Ruling No. 456-88, supra.), that under the most favored nation provision of the RP-US Tax Treaty (Article 13, paragraph 2(b)(iii), the tax imposable on royalties derived by a resident of the United States from sources within the Philippines shall be the lowest rate of Philippine tax that may be imposed on royalties of the same kind paid under similar circumstances to a resident of a third state. Article 12, paragraph 2(b) of the RP-West Germany Tax Treaty, provides that royalties arising in the Philippines and paid to a resident of West Germany may also be taxed in the Philippines, but the tax so charged shall not exceed 10% of the gross amount of royalties. Said treaty also provides that for as long as the transfer of technology under Philippine law, is subject to approval, the limitation of the tax rate in case of royalties arising in the Philippines, apply if the contract giving rise to such royalties has been approved by Philippine competent authorities."

The same argument has been raised by the respondent on appeal to the Court of Appeals but the same was dismissed in the case of **Commissioner of**

Internal Revenue vs. S.C. Johnson and Son, Inc., CA-G.R. No. SP 40802, November 6, 1996, where it was held:

> "We do not agree for two main reasons:
>
> ***One.*** The BIR Commissioner's interpretation of Article 13(2)(b)(iii) of the RP-U.S. Tax Treaty, supra, which is the principal basis of her position in the issue at bench is incorrect. The phrase 'paid under similar circumstances' is followed by the phrase 'to a resident of a third state'. Since what is paid to a resident of a third state is not a tax but a royalty, logic instructs that said provision of the treaty refers to royalties of the same kind paid under similar circumstances to a resident of a third state. *Verba accipiendo sunt secundum materiam.* Words are to be understood in the context in which they are used. Articles 13, paragraph 2(b)(iii) has nothing to do with the payment of taxes under similar circumstances. We quote with approval the explanation given by IBM Philippines, Inc. in another case which is reproduced in the Comment of the respondent, to wit:
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> > 'The requirement of "similar circumstances" is in relation to the payment of royalty, not payment of the tax. Thus, for instance, the royalty in question paid to a U.S. President by petitioner (which is neither BOI-registered enterprise, nor engaged in a preferred-piomeer activity) is not paid under similar circumstances as a royalty paid to an Australian resident by a Philippine company that is BOI-registered and engaged in a preferred-pioneer activity. Also, a royalty paid to a resident of Denmark or Sweden in respect of motion picture films and tapes is not paid under similar circumstance as the royalty herein paid by petitioner to its U.S. licensors. Clearly, the phrase "similar circumstances" is used in reference to the payment of the royalty, and not in reference to the payment of the tax.' (p. 9, Comment)
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> ***Two.*** The basis of petitioner BIR Commissioner's position on the issue at bench is RMC 39-92 which, alas, has already been abandoned by that agency no less. As a background, it should be noted that the BIR through the years has been inconstant on the issue of whether American firms are entitled to the 'most favord nation' tax rate on royalties derived in this country. Needless to say that this zig-zagging policy movements are inimical to public

interest for they cause instability in our tax structure. No business house, local or foreign, would like to operate in a country where it is made to guess from time to time what is the tax policy or ruling of the revenue collecting agency of the State. Le us follow the meanderings of the BIR on the issue at bench.

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

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

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

But that was not the end of the BIR's flip-flopping motions. This last time however was for the better. On March 6, 1995, it issued BIR Ruling No. 052-95 expressly revoking BIR Ruling 003-93 issued on January 16, 1993 which applied the discredited RMC 39-92. BIR Ruling No. 052-95 states in part:

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

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

We do not intend to depart from the wisdom of said decision and thus, the same should be applied in the case at bar.

To prove its claim, petitioner presented evidences properly identified by its witnesses, on the alleged amount sought to be refunded, by submitting during the trial of this case the following:

(1) Monthly Remittance Return of Income Taxes Withheld covering the period October 01, 1991 to June 30, 1993 (Exhs. F, K, M, O, Q and U);

(2) Certificate of Registration with the BPTTT (Exh. D);

(3) EDP Software and Technical Information Renewal License Agreement (Exh. C);

(4) IFP Payment Vouchers issued in favor of the Commissioner of Internal Revenue (Exhs. E, G, I, L, N, P and T);

(5) Claims for refund dated April 22, 1993 and January 25, 1994 (Exhs. V and X, respectively); and

(6) Statements of Royalty Payable (Exhs. AA, CC, EE, GG, II and KK).

After going over the evidences and evaluating the same, this Court finds that petitioner has indeed overpaid the withholding taxes on royalties, hence, entitled to a refund. However, We cannot grant the total amount claimed in this petition for review on account of prescription. It should be noted that claims for refund must be made within two years from the date of payment in accordance with Section 230 of the Tax Code, as amended, which provides:

> "**Sec. 230.** ***Recovery of tax erroneously or illegally collected.*** - No suit or proceeding shall be maintained in any court for the recovery of any national internal revenue tax hereafter alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Commissioner of Internal Revenue; but such suit or proceeding may be maintained, whether or not such tax, penalty or sum has been paid under protest or duress. In any case, no such suit or proceeding shall be began 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: Provided, however, that the Commissioner may even without a written claim therefor, refund or credit any tax, where on the face of the return upon which payment was made."

This petition for review was filed on September 22, 1994, therefore the remittance of withholding taxes paid on July 10, 1992 amounting to

P612,822.00 had prescribed and can no longer be included in the amount to be awarded by this Court. Per our computation, the petitioner is entitled to a refund of P1,814,689.20, computed as follows:

Period Covered	25% Tax Withheld	Date Remitted to the BIR	Tax Refund
10-01-91 to 12-31-91	P 210,236.00	09-23-92	P 126,141.60
	420,473.00	10-16-92	252,283.80
01-01-92 to 03-31-92	96,174.00	09-23-92	57,704.40
	192,349.00	10-16-92	115,409.40
04-01-92 to 06-30-92	198,265.00	10-16-92	118,959.00
07-01-92 to 09-30-92	623,886.00	10-16-92	374,331.60
10-01-92 to 12-31-92	189,181.00	03-10-93	113,508.60
01-01-93 to 06-30-93	1,093,918.00	11-10-93	656,350.80
Total	P3,024,482.00		P1,814,689.20

WHEREFORE, in view of all the foregoing, respondent is hereby ordered to refund to petitioner the amount of P1,814,689.20 representing erroneously remitted taxes withheld on royalties from October 1, 1991 to June 30, 1993. No cost of suits.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

RAMON O. DE VEYRA
Associate Judge

AMANCIO Q. SAGA
Associate Judge

CERTIFICATION

I hereby certify that this decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals