REPUBLIC OF THE PHILIPPINES
Court Of Tax Appeals
QUEZON CITY

SECOND DIVISION

SMART COMMUNICATIONS, INC., *Petitioner,*	**C.T.A. CASE NO. 6782**
	Members:
-versus-	CASTAÑEDA, JR., Chairman UY, and PALANCA-ENRIQUEZ, JJ.
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	**Promulgated:** FEB 2 3 2006

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DECISION

PALANCA-ENRIQUEZ, J.:

Withholding agents are considered broadly as taxpayers within the meaning of the Tax Code, since they are liable or are subject to the payment of taxes. The withholding agent is both the agent of the government and of the taxpayer with respect to the filing of the necessary income tax return and the actual payment of the tax which includes the authority to file a claim for refund and bring an action for recovery of such claim.

THE CASE

This is a Petition for Review filed by SMART COMMUNICATIONS, INC. (hereafter "petitioner") praying for refund or issuance of a tax credit certificate in the amount of P7,008,840.43 representing erroneously paid final withholding tax for the month of August 2001.

THE FACTS

In their "Joint Stipulation of Facts", the parties submitted the following:

> "1.02. Petitioner is a corporation organized and existing under Philippine law with principal office at the Smart Tower, Ayala Avenue, 1226 Makati Avenue.
>
> 1.03. Respondent is the duly appointed Commissioner of Internal Revenue (CIR) vested with authority to exercise the functions of said office, including inter alia, the power to refund any internal revenue tax erroneously or illegally assessed or collected, or of any penalty claimed to have collected without authority, or any sum alleged to have been excessively or in any manner wrongfully collected, and holding office at the BIR National Office Building, Diliman, Quezon City, where he may be served with summons and other legal processes of this Honorable Court (ANSWER, par. 1).
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> 1.04. SMART is an enterprise duly registered with the Board of Investment (BOI) on a preferred non-pioneer status, having been issued the following BOI Certificates:

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BOI Certificate of Registration No.	Registered Activity
94-034 dated March 8, 1994	New operator of a nationwide enhanced Cellular Mobile Telephone System (CMTS)
94-628 dated December 29, 1994	New operator of International Gateway Facility ("IGF")
97-117 dated August 26, 1997	Expanding Operator of Nationwide Cellular Mobile Telephone System (CMTS)
2001-066 dated May 3, 2001	Expanding Operator of Telecommunication Systems (Nationwide Cellular Mobile Telephone Services- Global system for Mobile Communication (GSM) Network
2001-102 dated July 12, 2001	New IT Service Firm in the Field of Information Technology Service (Payment Infrastructure System)

1.05. In line with its Bespoke Project and the launching of its *mCommerce* service such as Smart Banking, Smart Money and ZED Mobile service initiatives, SMART entered into three (3) Agreements for Programming and Consultancy Services (collectively the "Agreements") with Prism Transactive (M) Sdn Bhd, Inc. ("Prism").

1.06. Prism is a non-resident corporation duly organized and existing under the laws of Malaysia.

1.07. SMART withheld and paid to the BIR withholding taxes totaling Seven Million Eight Thousand Eight Hundred Forty and 43/100 Pesos (P7,008,840.43) applying the tax rate of 25%, as follows:

Particulars	Amount
Tax Base	US$ 547,822.45
Multiply by: Withholding Tax rate	25%
Final Withholding Tax	US$ 136,955.61
Multiply by: Prevailing	51.176

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Exchange Rate	
FWT remitted to the BIR	P 7,008,840.43

1.08. SMART filed its Monthly Remittance of Final Income Taxes Withheld (BIR Form No. 1601-F) for the month of August 2001 on September 25, 2001.

1.09. On September 23, 2003, SMART formally filed a claim with the BIR, through the International Tax Affairs Division ("ITAD"), for the refund of its overpaid or erroneously paid final withholding tax for the month of August 2001.

1.10. Respondent Commissioner has not acted upon or granted said written claim for refund. Thus, SMART filed the instant Petition to forestall the running of the prescriptive period."

In his answer, respondent alleged by way of special and affirmative defenses:

"4. The "Agreements" attached as Annexes "I-K" of the petition are unnotarized documents. Respondent, thus has no way of checking the veracity of the scope of obligations of both parties under the agreements..

5. Further, the Completion of Work Certificate given by PRISM TRANSACTIVE (M) SDN. BHD. ("Prism") is unauthenticated by the Malaysian Embassy. Reliance cannot be had on the said certification absent authentication by the Malaysian Embassy or the Philippine Consulate Office in Malaysia.

6. The billing statement relied upon to prove payment to Prism does not in any way show proof that the

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payment was made thereon. It does not show that remittance was made to Prism in the stated amount.

7. Petitioner is not the party-in-interest in this case to recover the amount it paid to the respondent. In fact, petitioner is deemed as the agent of the government in collecting the Seven Million Eight Thousand Eight Hundred Forty Pesos and Three Centavos (Php 7,008,840.03), constituting final tax on passive income of royalty to Prism. Even under the cited "RP-Malaysia" Tax Treaty, it is Prism who is the proper party-in-interest to seek for the refund of said amount as it is deemed to be the one to have been prejudiced by the withholding of the tax on royalty payment. Thus, herein petitioner SMART is not the proper party-in-interest in this case. Clearer still, it is not entitled to the reliefs of the treaty provision as it is not a Malaysian Company entitled to privileges under the treaty.

8. Assuming in grantia arguenti that petitioner is the proper party in interest, it cannot rely its claim for refund on the treaty provisions:

> a. Petitioner failed miserably to establish that what were paid were business profits. Assuming that the payment for services rendered are not royalty payments, petitioner still failed to prove that what were remitted to Prism were business profits. Petitioner cannot rely on implications that since the payments were not royalty payments, they are business profits and thus covered by the treaty. An exemption from common burdens cannot be made to rely on vague implications (Asiatic Petroleum Co. {P.I.} v. Llanes, 49 Phil. 466).
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> b. The interpretation by the Organization for Economic Cooperation and

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> Development Committee on Fiscal Affairs through the Technical Advisory Group on Treaty Characterization of Electronic Commerce Payments is likewise not the authority on the matter. In a dispute between the petitioner and respondent, petitioner cannot rely on the construction of international agreements, which are not treaty provisions between the Philippines and Malaysia. These international agreements are not parts of the law of the land. In this claim for refund the governing authority is the ordinary meaning of royalties, as this is the one being used by the Philippine Government for taxation purposes. Royalties as generally used in this jurisdiction mean "payment of any kind received as a consideration of the use of, or the right to use, any copyright of literary, artistic or scientific work including… 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". From this general definition of royalties, it is perfectly lucid that the payments made by petitioner to Prism are royalty payments. This position is buttressed by recent Revenue Memorandum Circular No. 77-2003 issued by the respondent. Thus, petitioner could not be deemed to be in error in its payment of the amount being claimed for refund in this petition.

9. Petitioner's claim for refund is subject to administrative investigation/examination by the respondent. However, due to its act of belated filing, one day before the expiry of the two-year period, it deprived the respondent of reasonable opportunity to act on its claim for refund.

> 10. In an action for refund, the burden of proof is on the taxpayer to establish its right to refund. Failure to sustain the burden is fatal to the claim for refund/credit. This is so because exemptions from tax are highly disfavored in law, and he who claims exemption must be able to justify his claim by the clearest grant of organic or statutory law.
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> 11. Claims for refund are construed strictly against the claimant, for the same partake the nature of exemption from taxation."

Petitioner presented Rina Lorena R. Manuel and Jose Crisanto B. Magno, as witnesses, and submitted its Formal Offer of Evidence, which was admitted by the Court, subject to a final evaluation as regards their probative value.

On the other hand, at the hearing on May 18, 2005, respondent manifested that he will no longer present evidence, and moved that the parties be given thirty (30) days therefrom within which to file their simultaneous memoranda, which the Court granted.

Both parties having complied thereto, the case was deemed submitted for decision.

ISSUES

As stipulated upon by the parties, the following are the issues for this Court's consideration:

I

WHETHER OR NOT SMART IS THE PROPER PARTY-IN-INTEREST TO CLAIM REFUND.

II

WHETHER OR NOT PAYMENTS MADE BY SMART TO PRISM ARE CONSIDERED ROYALTIES OR ARE MERE BUSINESS PROFITS.

III

WHETHER OR NOT SMART IS ENTITLED TO THE PROVISION OF THE RP-MALAYSIA TAX TREATY ON BUSINESS PROFITS.

IV

WHETHER OR NOT SMART IS ENTITLED TO A REFUND IN THE AMOUNT OF SEVEN MILLION EIGHT THOUSAND EIGHT HUNDRED FORTY AND 43/100 PESOS (P7,008,840.43).

THE COURT'S RULING

The petition is partly meritorious.

First and Third Issues:
Petitioner Is the Proper
Party-In-Interest

Being interrelated, the first and third issues will be discussed jointly.

Invoking the cases of *Commissioner of Internal Revenue vs Wander Philippines, Inc., 160 SCRA 577*, and *Commissioner of Internal Revenue vs. Procter & Gamble Philippine Manufacturing Corporation, 204 SCRA 387*, petitioner maintains and argues that as a withholding agent, it is the proper party to file the claim for refund.

On the other hand, respondent counterargues that the record of the case is devoid of any representation that petitioner brought the instant case as an agent of Prism, the payee. There was no Special Power of Attorney presented to prove that Prism constituted the petitioner as its agent for purposes of this case.

We rule for the petitioner.

The issue of whether or not a withholding agent is the proper party to claim for the refund of overpayment of withholding tax is not novel, as the issue had, in a number or so of cases, been previously ruled upon by the Supreme Court.

In *Commissioner of Internal Revenue vs. Wander Philippines, Inc., 160 SCRA 577*, the Supreme Court said that Wander Philippines, as the Philippine counterpart, is the proper party who should claim for the refund, and ruled as follows:

> "In any event, the submission of petitioner that Wander is but a withholding agent of the government and therefore cannot claim reimbursement of the alleged overpaid taxes, is untenable. It will be recalled, that said corporation is first and foremost a wholly owned subsidiary of Glaro. The fact that it became a withholding agent of the government which was not by choice but by compulsion under Section 53 (b) of the Tax Code, cannot by any stretch of the imagination be considered as an abdication of its responsibility to its mother company. Thus, this Court construing Section 53 (b) of the Internal Revenue Code held that 'the obligation imposed thereunder upon the withholding agent is compulsory.' It is a device to insure the collection by the Philippine Government of taxes on incomes, derived from sources in the Philippines, by aliens who are outside the taxing jurisdiction of this Court (Commissioner of Internal Revenue vs. Malayan Insurance Co., Inc., 21 SCRA 944). In fact, Wander may be assessed for deficiency withholding tax at source, plus penalties consisting of surcharge and interest (Section 54, NLRC). Therefore, as the Philippine counterpart, Wander is the proper entity who should claim for the refund or credit of overpaid withholding tax on dividends paid or remitted by Glaro."

In *Commissioner of Internal Revenue vs. Procter and Gamble Philippine Manufacturing Corporation, 204 SCRA 384-387*, the Supreme Court, in its Resolution granting Procter and Gamble Philippine Manufacturing Corporation's Motion For Reconsideration and setting aside the decision of the Second Division promulgated on April 15, 1988, ruled that a withholding agent is properly regarded as a "taxpayer" within the meaning of *Section 309 of the NIRC*, and is impliedly authorized to file the claim for refund and the suit to recover such claim, as follows:

> "Section 309 (3) of the NIRC, in turn, provides:
>
> > 'Section 309. *Authority of Commissioner of Take Compromises and to Refund Taxes.*- The Commissioner may:
> >
> > xxx xxx xxx
> >
> > (3) credit or refund taxes erroneously or illegally received, x x x. *No credit or refund* of taxes or penalties *shall be allowed unless the taxpayer files in writing* with the Commissioner *a claim for credit or refund* within two (2) years after the payment of the tax or penalty. (As amended by P.D. No. 69) (Emphasis supplied)
>
> Since the claim for refund was filed by P&G-Phil., the question which arises is: is P&G-Phil. a '*taxpayer*' under Section 309 (3) of the NIRC? The term '*taxpayer*' is defined in our NIRC as referring to '*any person subject to tax* imposed by the Title [on Tax on Income].' (Section 20 (n), NIRC (as renumbered and re-arranged by Executive Order No. 273, 1 January 1988). It thus becomes important to note that under Section 53 (c) of the NIRC, the withholding agent who is 'required to deduct and withhold any tax' is made '*personally liable for such tax*' and indeed is indemnified against any claims and demands which the stockholder might wish to make in questioning the amount of payments effected by the withholding agent in accordance with the provisions of the NIRC. The withholding agent, P&G-Phil., is *directly and independently liable* (E.g., Section 51 (e),

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> NIRC) for the correct amount of the tax that should be withheld from the dividend remittances. The withholding agent is, moreover, subject to and liable for deficiency assessments, surcharges and penalties should the amount of the tax withheld be finally found to be less than the amount that should have been withheld under law.
>
> A 'person liable for tax' has been held to be a 'person subject to tax' and properly considered a 'taxpayer.' [Houston Street Corporation v. Commissioner of Internal Revenue, 84 F. 2nd. 821 (1936); Bank of America v. Anglim, 138 F. 2nd. 7 (1943)] The terms liable for tax' and 'subject to tax' both connote legal obligation or duty to pay a tax. It is very difficult, indeed conceptually impossible, to consider a person who is statutorily made 'liable for tax' as *not* 'subject to tax.' By any reasonable standard, such a person should be regarded as a party in interest, or as a person having sufficient legal interest, to bring a suit for refund of taxes he believes were illegally collected from him."

Then, in *Commissioner of Internal Revenue vs. The Court of Tax Appeals, G.R. No. 93901, February 11, 1992*, which involved the issue of whether or not Hawaiian Philippines Co. has legal capacity to file a claim for refund of withholding tax on behalf of its non-resident U.S. stockholders, the Supreme Court ruled that a withholding agent has sufficient legal interest to bring an action to recover tax overpayment.

The foregoing rulings treated the withholding agent as a taxpayer in view of its direct and independent liability under the withholding tax system. Pursuant to the aforequoted decisions of the Supreme Court, the

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withholding agent is the agent of both the government and the taxpayer. With respect to the filing of the necessary income tax return and the actual payment of the tax which includes the authority to file a claim for refund and to bring an action for recovery of such claim, he is the agent of the taxpayer, and with respect to the collection and/or withholding of the tax, he is the Government's agent (*Principles and Remedies, 2nd ed. 2005, pp. 190-191, by Justice Japar B. Dimaampao*).

Consequently, We rule that herein petitioner, as the withholding agent, is the proper party to file the present claim for refund.

Second Issue:
Are Payments Made By Petitioner Considered Royalties?

The importance of determining whether or not the payments made by petitioner are considered royalties lies in the fact that it affects the taxability of the payments thereof. As advanced by petitioner, if the payments are considered business profits, other than royalties, then the same shall not be taxable in the Philippines, citing *Article 7 of the RP-Malaysia Tax Treaty*, which in pertinent part provides:

"Article 7
BUSINESS PROFITS

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only on so much thereof as is attributable to that permanent establishment."

Corollary thereto, petitioner further claims that Prism did not establish a permanent establishment in the Philippines. Thus, any business profit that Prism received in the Philippines, during the subject period, shall not be taxable pursuant to the above quoted-portion of the *RP-Malaysia Tax Treaty*.

On the other hand, respondent maintains that payments to Prism are royalty payments subject to final withholding tax, and are, thus, not covered by the Treaty provisions on business profits.

Petitioner's contention is partly meritorious.

Article 12 of the RP-Malaysia Tax Treaty provides as follows:

"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, if such resident is the beneficial owner of the royalties.

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2. Such royalties may also be taxed in the contracting State in which they arise, and according to the laws of that State. However, if the recipient is the beneficial owner of the royalties:

   a. xxx xxx
   b. in the case of the Philippines:
      the tax so charged shall not exceed:
      (i) 15 per cent of the gross amount of the royalties where the royalties are paid by a registered enterprise as well as royalties defined in paragraph 4(a)(ii); and
      (ii) 25 per cent of the gross amount of the royalties in all other cases.

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Under *Article 12 (par. 4) of the RP-Malaysia Tax Treaty*, the term "royalties" means:

"4. (a) The term 'royalties' as used in this Article means payments of any kind received as consideration for:

(i) the use of, or the right to use, any patent, trade mark, design or model, plan, secret formula or process, any copyright of literary, artistic or scientific work, or for the use of, or the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial or scientific experience;

(ii) the use of, or the right to use, cinematograph films, or tapes for radio or television broadcasting."

On the other hand, *Article 7 on Business Profits of the RP-Malaysia Tax Treaty*, provides:

"Article 7
BUSINESS PROFITS

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only on so much thereof as is attributable to that permanent establishment."

After a careful examination of the three specific projects entered into between the petitioner and Prism, namely: Service Download Manager ("SDM"), Channel Manager ("CM") and Smart Money and Mobile Banking SIM Applications ("SIM Application") and Private Text Platform, the Court finds that project SDM is a royalty, as contemplated under *Article 12, paragraph 4 of the Treaty*. In this regard, *paragraph 1 of the Programming Services – Schedule A* (*Exhibit "1"*) provides:

"1. SERVICE DOWNLOAD MANAGER

The Service Download Manager ("SDM") provides the functionality to manage WIB applications on the SIM. It allows application to be downloaded to the SIM in a queue fashion and integrates with Smart Trust's DP5 platform in this regard. It also performs the required cryptographic operations on the download instructions prior to sending the message to the SIM. The SDM is the intellectual property of PRISM.

1.1 SDM Functions

The functions that the SDM perform include:

- Updating a database of the available applications that can be downloaded to a SIM
- Updating a database of the current status of the SIM with respect to installed applications, available space for applications etc.
- Providing a SIM update service for non-application updates to the SIM eg. List updates
- Formatting the Prism SIM specific application update WML to byte code
- Logging all SIM updates performed either successful or unsuccessful
- Queuing all requested SIM updates and ensuring that all SIM update requests are attempted within a specific period of time

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1.3 Intellectual Property Rights (PR)

The SDM shall be installed by PRISM, including the SDM Libraries, the IPR of which shall be retained by PRISM. PRISM, however, shall provide the Client the APIs for the SDM at no cost to the Client. The Client shall be permitted to develop programs to interface with the SDM or the SDM Libraries, using the related APIs as appropriate."

Under the above provision of the Programming Services, it is clear that the SDM is the intellectual property of PRISM. It further provides that the SDM shall be installed by PRISM, including the SDM Libraries, the intellectual property right of which shall be retained by PRISM.

Petitioner availed an already existing program "SDM" from PRISM, contrary to its statement that PRISM is to undertake to perform service which will result in the creation, development or bringing into existence of a product, like SDM. Thus, payments to PRISM for the installation of the SDM are clearly royalties and are therefore taxable.

As regards the *Channel Manager (CM) Agreement, paragraphs 1 and 1.4 of the Programming Services (Schedule A)* read:

> "1. CHANNEL MANAGER
>
> The Channel Manager ('CM') will provide the content interface to the WIB via DP5. There are two CM platforms defined. One will provide ZED functionality and the other would provide Mobile Banking and Smart Money transactions to the SIM.
>
> The ZED version of CM will be delivered first and must be in place when the first SIMs are released to the market. The Mobile Banking and Smart Money applications are hidden when the SIM is released and as such, the CM that enables these services will be provided after the ZED CM.

The ZED Channel Manager will be developed as Enterprise Java Beans ('EJB') to be run on the Netscape iPlanet application server. A set of services will receive the SIM requests via DP5 and then hand the transaction request to the EJB components. The SMART Money / MBS Channel Manager will be developed under the PHP development environment.

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1.4 Intellectual Property Rights (IPR)

The IPR of all components of the CM belong to the Client with the exception of the following components, which are provided, without technical or commercial restraints or obligations:

- ConfigurationException.java
- DataStructures(DbLinkedList.java,DbIListNode.java.ListEmptyException.java,ListFullException.java,ListNodeNotFoundException.java,QueueEmptyException.hjava,QueueFullException.java,QueueList.java,QueueListEx.java,andQueueNodeNotFoundException.java)
- FieldMappedObject.java
- LogFileEx.java
- Logging (BaseLogger.java and Logger.java)
- PrismGeneric Exception.java
- PrismGenericObject.java
- ProtocolIBuilders/CIMD2(Alive.java,BaseMessageData.javaDeliverMessage.java,Login.java,Logout.java,Nack.java,SubmitMessage.java,
- TemplateManagement(FileTemplateDataBag.java,TemplateDataBag.java,TemplatgeManagerExBag.java,andTemplateParserExBag.java)
- TemplateManager.class
- TemplateServer.class

- TemplateServer$RequestThread.class
- Template Server_skel.class
- TemplateServer_stub.class
- TemplateService.class
- Prism Crypto Server module for PHP4

xxx xxx" (*Exhibit "J"*)

On the other hand, as regards the *SIM Application Agreement, paragraphs 1 and 1.3 of the Programming Services (Schedule A)* read:

"1. SMART MONEY AND MOBILE BANKING SERVICE SIM APPLICATIONS

In order to deliver the advanced level of SIM application that the Client requires in the timeframes requested, Prism will perform the WIB script development on the SIM, concluding with the 64k WIB script code referred to later.

The activities to be performed will be:

- Proof of concept and demonstration
- Several iterations of requirement analyses – rapid turnaround prototyping
- SIM application development and debugging
- Backend simulation development for application requirements refinement, application testing and functional/technical/performance evaluation for marketing acceptance sign-off.

1.1 Terms of Reference

The general terms of reference for the SIM Applications are set out below.

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1.3 Intellectual Property Rights (IPR)

> The Client shall own the IPR for the Specifications and the Source Code for the SIM Applications. PRISM shall develop an executable compiled code (the "Executable Version') of the SIM Applications for use on the aSIMetric card which, however, shall only be for the Client's use. The Executable Version may not be provided by PRISM to any third parties without the prior written consent of the Client. It is further recognized that the Client anticipates licensing the use of the SIM Applications, but it is agreed that no license fee will be charged to PRISM or to a licensee of the aSIMetrix card from PRISM when SIMs are supplied to the Client." (*Exhibit "K"*)

From the aforequoted provisions, it is clear that with respect to *CM and SIM Application Agreements*, PRISM applied existing knowledge, skills and expertise in the development of the software. The product/software created as a result of the services belongs to the petitioner. There is no existing product that petitioner is availing from PRISM, as distinguished from the SDM project. Thus, it can be concluded that payments to PRISM, with respect to *CM and SIM Application Agreements*, are not royalties, rather they are considered payments for professional services. *[illegible]*

The foregoing payments, except with regard to the SDM projects, are considered business profits within the meaning of the *RP-Malaysia Tax* Treaty, which is taxable in the Philippines only if it is attributable to permanent establishment in the Philippines, pursuant to *Article 7* of said *Treaty*, which provides:

> "Article 7
> BUSINESS PROFITS
>
> 1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only on so much thereof as is attributable to that permanent establishment."

On the other hand, *Article 5 of the RP-Malaysia Tax Treaty* defined the term "permanent establishment" as follows:

> "ARTICLE 5
> PERMANENT ESTABLISHMENT
>
> 1. For the purposes of this agreement, the term 'permanent establishment' means a fixed of business in which the business of the enterprise is wholly or partly carried on.
>
> 2. The term 'permanent establishment' shall include especially:
>
> (a) a place of management; *[initials]*

(b) a branch;
(c) an office;
(d) a factory;
(e) a workshop;
(f) a mine, an oil or gas well, a quarry or other place of extraction of natural resources including timber or other forest produce;
(g) a farm or plantation; a building site or construction, installation or assembly project which exists for more than 6 months.

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4. An enterprise of a Contracting State shall be deemed to have a permanent establishment in the other Contracting State if:

(a) it carries on supervisory activities in that other State for more than 6 months in connection with a construction, installation or assembly project which is being undertaken in that other State; or

(b) substantial equipment is in that other State being used or installed by, for or under contract with, the enterprise."

To prove that PRISM did not establish permanent establishment in the Philippines, petitioner presented the following documents:

1) the Completion of Work Certificate No. SM 0203 relating to the *SDM Agreement* (*Exhibit "M"*), which shows that the employees of PRISM stayed in the Philippines from July 23, 2001 to December 14,

2001 or for less than six (6) months from the time of the engagement until the *SDM Agreement* was completed;

2) the Completion of Work Certificate No. SM0102 relating to the *CM Agreement* (*Exhibit "N"*) which shows that the consultants and employees of PRISM stayed in the Philippines from July 23, 2001 to November 2, 2001 or for less than six (6) months from the time of the engagement until the *CM Agreement* was completed; and

3) the Completion of Work Certificate No. SM0101 relating to the *SIM Application Agreement* (*Exhibit "P"*), which shows that the consultants and employees of PRISM stayed in the Philippines from June 1, 2001 to July 27, 2001 or for a period of less than six (6) months from the time of the commencement of the engagement until the *SIM Application Agreement* was completed.

Considering that petitioner has clearly shown that PRISM did not establish a permanent establishment in the Philippines, then said payments, except with regard to the SDM project, are not taxable pursuant to *Article 7 (par. 1) of the RP-Malaysia Tax Treaty.*

For all the foregoing, and considering that petitioner has shown to the satisfaction of the Court that it actually remitted and paid the amount of P7,008,840.43 representing final withholding taxes (*Exhibit "D-2"*), and considering further that only the amount of $236,000.00 representing payment for SDM project (*Exhibit "R"*) is taxable under the Treaty, petitioner is entitled to a refund in the reduced amount of P3,989,456.43, computed as follows:

Particulars	Amount (in US$)
1. CM	296,000.00
2. SIM Application	15,822.45
Total	US$311,822.45

Particulars	Amount
Tax Base	US$311,822.45
Multiply by: Withholding Tax Rate	25%
Final Withholding Tax	US$ 77,955.61
Multiply by: Prevailing Exchange Rate	51.176
Tax Refund Due	P3,989,456.43

WHEREFORE, premises considered, the instant petition is hereby partially **GRANTED**. Accordingly, respondent Commissioner of Internal Revenue is hereby **ORDERED** to **REFUND** or **ISSUE** a **TAX CREDIT CERTIFICATE** to petitioner Smart Communications, Inc. in the amount of P3,989,456.43, representing overpaid final withholding taxes for the month of August 2001.

SO ORDERED.

OLGA PALANCA-ENRIQUEZ
Associate Justice

WE CONCUR:

JUANITO C. CASTAÑEDA, JR.
Associate Justice

ERLINDA P. UY
Associate Justice

A T T E S T A T I O N

I attest that the conclusions in the above Decision were reached in consultation before the cases were assigned to the writer of the opinion of the Court's Division.

JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairman, Second Division

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

Pursuant to Article VIII, Section 13 of the Constitution, and the Division Chairman's Attestation, it is hereby certified that the conclusions in the above Decision were reached in consultation before the cases were assigned to the writer of the opinion of the Court's Division.

ERNESTO D. ACOSTA
Presiding Justice