REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

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PHILIPPINE COMPUTER ASSOCIATES INTERNATIONAL, INC.,
Petitioner,

C.T.A. CASE NO. 6864

Members:

- versus -

ACOSTA, *Chairman*
BAUTISTA, and
CASANOVA, *JJ.*

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
AUG 04 2006

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DECISION

BAUTISTA, L., J.:

This case involves a claim for refund in the total amount of ₱5,555,304.40 allegedly representing petitioner's excess final withholding taxes paid on royalty payments covering the taxable period January 2002 to May 2003.

Culled from the parties' stipulated facts and adduced evidence are the following sets of facts:

Petitioner is a domestic corporation duly organized and existing under the laws of the Philippines with principal office at the 30th Floor, Philam Life Tower, 8767 Paseo de Roxas, Makati City. It is duly registered as a taxpayer and was issued Registration Certificate No. OCN9RC0000036884 on October 3, 1990 by the Bureau of Internal Revenue (BIR).

Respondent is the Commissioner of Internal Revenue duly appointed as the head of the BIR and vested with the power and authority to refund any internal revenue taxes erroneously or illegally assessed or collected, or of any penalty collected without authority, or of any sum excessively or in any manner wrongfully collected, including excess final withholding taxes. He holds office at the BIR National Office Building, Diliman, Quezon City.

On April 1, 1993, petitioner entered into a Distributor Agreement with CA Management, Inc., a non-resident foreign corporation duly organized and existing under the laws of the State of Delaware, U.S.A. which is engaged in the business of marketing mainframe and midrange computer software program products. The parties renewed the Agreement on April 1, 1994 by virtue of Renewal Distributor Agreement. Both the Distributor Agreement and the Renewal Distributor Agreement were registered with the Bureau of Patents, Trademarks, and Technology Transfer on October 5, 1993 and August 19, 1994, respectively.

Under the Agreements, CA Management, Inc. granted petitioner the exclusive rights within the Philippines to (i) distribute applications and systems software (the "Products") developed by CA Management; (ii) utilize certain know-how and information concerning installation and use of the Products, for purposes of marketing and licensing the Products in the Philippines; and (iii) to use Trademarks, as defined therein, in marketing the Products in the Philippines. For its part, petitioner agreed to pay CA Management, Inc. monthly commissions (royalties) equivalent to 35% of all the license and maintenance fees, exclusive of any sales tax, which petitioner shall receive in connection with the distribution of the Products in the Philippines.

Petitioner filed its monthly remittance return of final withholding taxes on the royalties paid to CA Management, Inc. for the period January 2002 to May 2003. The returns and the supporting schedules showed the following royalty payments with the related 15% final withholding taxes in the total amount of ₱16,665,913.00:

Tax Period	EXHIBIT *(Inclusive of Submarkings)*	Date of payment and remittance of Withholding Tax	Royalty	Tax Withheld on Royalties at 15%
January 2002	H	February 11, 2002	₱ 12,179,934.00	₱ 1,826,990.00
February 2002	I	March 8, 2002	2,615,609.00	392,341.00
March 2002	J	April 10, 2002	22,406,089.00	3,360,913.00
April 2002	K	May 10, 2002	3,947,020.00	592,053.00
June 2002	M	July 9, 2002	2,361,020.00	354,153.00
July 2002	N	August 9, 2002	405,179.00	60,777.00
August 2002	O	September 10, 2002	3,574,525.00	536,179.00
October 2002	Q	November 11, 2002	4,333,567.00	650,035.00
November 2002	R	December 10, 2002	1,613,433.00	242,015.00
December 2002	S	January 10, 2003	28,668,475.00	4,300,271.00
January 2003	T	February 10, 2003	17,516,573.00	2,627,486.00
February 2003	U	March 7, 2003	2,110,292.00	316,544.00
March 2003	V	April 10, 2003	4,442,927.00	666,439.00
April 2003	W	May 9, 2003	4,735,063.00	710,260.00
May 2003	X	June 10, 2003	196,381.00	29,457.00
TOTAL				**₱ 16,665,913.00**

The amounts withheld by the petitioner on the royalties paid to CA Management, Inc. were based on fifteen percent (15%) of the total royalty payments remitted to CA Management, Inc. The fifteen percent (15%) rate was the preferential tax rate then applicable pursuant to the most-favored-nation clause under the RP-US Tax Treaty in relation to the RP-Russia Tax Treaty as confirmed by the BIR in a ruling dated February 12, 2001.

On January 1, 2002, RP-China Tax Treaty came into effect and provided that royalties paid to a resident of China, if the recipient is the beneficial owner of the royalties, shall not exceed ten percent (10%) of the gross amount of royalties arising from the use of, or the right to use, any patent, trademark, design or model, plan, secret formula or process, or from the use of, or the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial or scientific experience.

On September 2, 2002, Revenue Memorandum Circular No. 46-02 was issued confirming that US residents may invoke the preferential tax rate of ten percent (10%) on royalties accruing beginning January 1, 2002, arising in the Philippines "from the use of, or the right to use, any patent, trademark, design or model, plan, secret formula or process,..., or for information concerning industrial, commercial or scientific experience" under the RP-China Tax Treaty in accordance with Article 13(2)(b)(iii) of the RP-US Tax Treaty which provides that the tax imposed on residents of the United States shall not exceed 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".

Pursuant to Revenue Memorandum Circular No. 46-02 in relation to Article 13(2)(b)(iii) of the RP-US Tax Treaty and Article 12(2)(b) of the RP-China Tax Treaty, petitioner filed with the BIR on February 10, 2004, a letter requesting for the refund or issuance of a tax credit certificate in the amount of P5,205,131.23 representing final withholding taxes remitted in excess of the prescribed 10% tax on royalty payments made from January 1, 2002 to June 10, 2003.

The very next day, petitioner filed with this Court a Petition for Review praying for the refund of a higher amount of P5,555,304.40.

The parties agreed to submit the following issues for the Court to decide upon:

> 1. Whether or not petitioner's royalty payments to CA Management, Inc. is subject to ten percent (10%) tax rate on royalties;
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> 2. Whether or not petitioner complied with all the requirements of the law in order to be subject to the ten percent (10%) tax rate on royalties;
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> 3. Whether or not petitioner's claim for refund for the period February 2002 to June 2003 allegedly representing excess final withholding taxes in respect to royalty payments made to CA Management, Inc. is substantiated by documentary evidence;
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> 4. Whether or not CA Management, Inc. is a resident of the United States for income tax purposes, and for purposes of the relevant treaty provisions between the Philippines and the United States;

5. Whether or not Article 13(2)(b)(iii) of the RP-US Tax Treaty in relation to Article 12(2)(b) of the RP-China Tax Treaty is applicable to the transactions involved in the petition so as to entitle the petitioner to a refund of excess final withholding taxes for the period from January 2002 to May 2003.

Under the Distributor Agreement, CA Management, Inc. shall receive royalty payment from petitioner for each license and maintenance agreement for the products entered into by the latter with its clients. And, pursuant to Article 13 of the RP-US Tax Treaty,[1] royalties derived by a resident of either the United States of America or Republic of the Philippines from sources within the other state may be taxed by both states. However, in the case of the Philippines, the tax imposed shall be the least of:

(i) twenty-five (25%) percent of the gross amount of the royalties;
(ii) fifteen (15%) percent if the gross amount of the royalties, where the royalties are paid by a corporation registered with the Philippine Board of Investments and engaged in the preferred areas of activities; and
(iii) the lowest rate of Philippine tax that may be imposed on royalties of the same kind under similar circumstances to a resident of a third State.

From the above-quoted Article, the "most favored nation clause" must be interpreted in relation to Article 12 of the RP-China Tax Treaty. Article 12 ("Royalties") of RP-China Tax Treaty reads:[2]

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

[1] "Convention Between the Government Of the United States Of America And the Government Of the Republic Of the Philippines With Respect To Taxes On Income" signed on October 1, 1976.
[2] "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" signed on November 18, 1999.

b. 10 per cent of the gross amount of royalties arising from the use of, or the right to use, any patent, trademark, design or model, plan, secret formula or process, or from the use of, or the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial or scientific experience.

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

3. The term "royalties" shall mean 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.

Now, the phrase "royalties paid under similar circumstances" in the most favored nation clause of the RP-US Tax Treaty contemplates "circumstances that are tax-related." Applying the ruling of the Supreme Court in *Commissioner of Internal Revenue v. S.C. Johnson and Son, Inc.*,[3] the concessional tax rate of 10% provided for in the RP-China Tax Treaty should apply only if the taxes imposed upon royalties in the RP-US Tax Treaty and in the RP-China Tax Treaty are paid under similar circumstances. This means that the RP-US Tax Treaty grants similar tax relief to residents of the U.S. with respect to taxes imposable upon royalties earned from sources within the Philippines as those allowed to their Chinese counterparts under the RP-China Tax Treaty. The Supreme Court explained:

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

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3 309 SCRA 87, 107 [1999].

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. xxx"

Both the RP-US Tax Treaty and the RP-China Tax Treaty speak of tax on royalties for the use of, or the right to use any patent, trademark, design or model, plan, secret formula or process or other like right or property, or for the information concerning industrial, commercial or scientific experience. Both treaties also provide for avoidance or relief from double taxation, to wit:

RP-US TAX TREATY

"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 thereof), 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 per cent 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 (a)(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 at least 5 per cent

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 limiting the credit to the Philippines 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 Philippines 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-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."

As explained by this Court in *The Coca-Cola Export Corporation vs. The Commissioner of Internal Revenue*:[4]

"In this 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 the petitioner for the right to use TCCC's trademarks, secret processes and formulae, and other confidential know-how relating to or in connection with the manufacture of concentrate beverage bases and syrups.

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4 C.T.A. Case No. 6861, November 22, 2005.

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 a appropriate amount based upon the taxes paid or accrued to the Philippines) against the United States tax, but 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: 25% of the gross amount of royalties; 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.

"xxx xxx xxx

"Based on the above provisions, the concessional rates of 15% and 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) & (2) 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 Treaties reveals similar provisions on the relief from or avoidance of double taxation as those stipulated in the RP-US Tax Treaty. There is no provision on a "matching credit" similar to that found in the RP-West Germany Tax Treaty (Commissioner of Internal Revenue vs. SC Johnson and Son, Inc., supra). 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. It must be stressed that the purpose of the most favored nation clause is to grant to the contracting state treatment not less favorable that that which has been or may be granted to the "most favored" among other countries. This 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 (Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc., supra).

"This likewise finds support in BIR Ruling DA-ITAD No. 103-03 dated July 24, 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. A perusal of the RP-US, RP-Russia

and RP-China tax treaty provisions on the avoidance of double taxation shows a similarity on the manner of payment of taxes, that is, the allowable foreign tax credit on the three treaties is the amount actually paid in the Philippines.

"Such being the case, and since TCCEC is not registered and engaged in preferred areas of activities in the Philippines, royalties arising in the Philippines and payable to TCCC for 2001 are subject to tax at the rate of 15 per cent (15%) while royalty payments accruing beginning January 1, 2002 shall be subject to 10 per cent (10%) pursuant to Article 13 (2)(b)(iii) of the RP-US tax treaty, in relation to Article 12 (2)(b) of the RP-Russia and RP-China tax treaties, respectively. (BIR Ruling No. DA-ITAD-101-103 dated July 24, 2003; RMC 46-02 dated September 2, 2002)

"Moreover, Revenue Memorandum Circular No. 46-02, or the Memorandum Circular clarifying the implication of Article 12 (2)(b) on royalties of the RP-China Tax Treaty, which took effect on January 1, 2002 (Article 28 (2) RP-China Tax Treaty), in relation to Article 13 (2)(b)(iii) or the "most favored nation" clause of the RP-US Tax Treaty, confirmed petitioner's stand that the tax on royalties to resident of the United States and China can be considered as paid under similar circumstances.

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

In other words, petitioner is entitled to enjoy the most favored nation treatment as there is similarity in the circumstances of payment of taxes in both the RP-US Tax Treaty and the RP-China Tax Treaty.[5]

Further, petitioner was able to establish by competent evidence that it met the condition set forth in Article 12 of the RP-China Tax Treaty that "the contract giving rise to such royalties has been approved by the Philippine competent authorities." The Distributor Agreement was duly registered with the Technology Transfer Registry of the Bureau of Patents, Trademarks and Technology Transfer and was issued the corresponding Certificate of Registration No. 1177-B on October 5, 1993.[6] Likewise, the Renewal of Distributor Agreement was duly registered with the Technology Transfer Registry of the Bureau of

[5] *Commissioner of Internal Revenue v. S.C. Johnson and Son, Inc.*, 309 SCRA 87.
[6] Exhibit D.

Patents, Trademarks and Technology Transfer and was issued the corresponding Certificate of Registration No. 1606 on August 19, 1994 (valid from April 1, 1994 to March 31, 2004).[7]

Thus, the first, second, fourth and fifth issues are resolved in favor of the petitioner. As to the remaining issue of whether petitioner was able to substantiate by documentary evidence its claim for refund, the Court rules in the affirmative.

Petitioner claims that it is entitled to the refund of excess final withholding taxes relative to the royalty payments it made to CA Management, Inc. for the period January 2002 to May 2003, computed as follows:

Tax Period	Actual 15% Final Tax Withheld on Royalties	Final Tax Withheld Computed at 10% of Royalties Paid	Difference
January 2002	₱ 1,826,990.00	₱ 1,217,993.40	₱ 608,996.60
February 2002	392,341.00	261,560.90	130,780.10
March 2002	3,360,913.00	2,240,608.90	1,120,304.10
April 2002	592,053.00	394,702.00	197,351.00
June 2002	354,153.00	236,102.00	118,051.00
July 2002	60,777.00	40,517.90	20,259.10
August 2002	536,179.00	357,452.50	178,726.50
October 2002	650,035.00	433,356.70	216,678.30
November 2002	242,015.00	161,343.30	80,671.70
December 2002	4,300,271.00	2,866,847.50	1,433,423.50
January 2003	2,627,486.00	1,751,657.20	875,828.70
February 2003	316,544.00	211,029.20	105,514.80
March 2003	666,439.00	444,292.70	222,146.30
April 2003	710,260.00	473,506.30	236,753.70
May 2003	29,457.00	19,638.10	9,818.90
TOTAL	**₱ 16,665,913.00**	**₱ 11,110,608.60**	**₱ 5,555,304.40**

To substantiate this claim, petitioner presented its "Monthly Remittance Return of Final Income Taxes Withheld" for the taxable months of January 2002 to May 2003;[8] official receipts issued by the Land Bank of the Philippines;[9] and Land Bank of the Philippines BIR-Tax Payment Deposit Slips.[10] These documentary evidence clearly show that petitioner

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7 Exhibit E.
8 Exhibits H to X.
9 Exhibits H-1, K-1 and Q-1.
10 Exhibits R-1, S-1, T-1, U-1, V-1 and W-1.

actually withheld and remitted to the BIR the total amount of ₱16,665,913.00 which is equivalent to 15% of the Royalty Payments. Moreover, petitioner presented various "Applications for Fund Transfer and Payment Details"[11] to prove that indeed it paid CA Management, Inc. the royalties due for the subject period, which were used as the bases for the computation of the 15% final withholding taxes on royalties.

In addition, it was also established that petitioner complied with the two-year prescriptive period for the filing of a claim for refund both in the administrative and judicial levels as set forth under Sections 204(C) and 229 of the NIRC of 1997, as amended. Counting from the respective dates when petitioner filed its Monthly Remittance Returns of Final Income Taxes Withheld for the taxable months of January 2002 to May 2003, the earliest of which was filed on February 11, 2002, both the administrative claim filed on February 10, 2004 and the Petition for Review filed on February 11, 2004 were timely made. However, Section 229 in relation to Section 204 (C) of the NIRC of 1997, as amended, provides that no suit or proceeding shall be maintained in any court for the recovery of any national internal revenue tax alleged to have been erroneously or excessively collected, until a claim for refund has been duly filed with respondent Commissioner. Thus considering that petitioner filed only an administrative claim for refund of erroneously paid final withholding taxes on royalty payments in the amount of P5,205,131.23, it can only be entitled to a refund of the same amount.

WHEREFORE, the Petition for Review is hereby **GRANTED**. Accordingly, the respondent is **ORDERED** to refund to petitioner the amount of FIVE MILLION TWO HUNDRED FIVE THOUSAND ONE HUNDRED THIRTY ONE PESOS AND TWENTY THREE CENTAVOS (₱5,205,131.23) representing excess final withholding taxes on royalty payments covering the taxable period January 2002 to May 2003.

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11 Exhibits Z, AA, BB, CC, DD, EE, HH, II and NN in relation to Exhibit OO.

SO ORDERED.

LOVELL R. BAUTISTA
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

CAESAR A. CASANOVA
Associate Justice

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Justice
Chairperson, First Division