Republic of the Philippines
Supreme Court
Manila

THIRD DIVISION

CARGILL PHILIPPINES, INC., Petitioner,	**G.R. No. 203346**
	Present:
-versus-	LEONEN, GESMUNDO, CARANDANG, ZALAMEDA, and GAERLAN, *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	**Promulgated:** September 9, 2020 MistDcBatt

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DECISION

LEONEN, *J.*:

Two conditions must be met for the most favored nation clause to apply: (1) similarity in subject matter, *i.e.* that royalties derived from the Philippines by a resident of the United States and of the third state are of the same kind;[1] and (2) similarity in circumstances in the payment of tax, *i.e.* the same mechanism must be employed by the United States and the third state in mitigating the effects of double taxation.[2] Failure to meet these conditions means the clause cannot apply.

This Court resolves a Petition for Review on Certiorari[3] assailing the Decision[4] and Resolution[5] of the Court of Tax Appeals *En Banc*, which

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[1] Id. at 23.

[2] Id. at 25.

[3] *Rollo*, pp. 10–69.

[4] Id. at 89–114. The May 24, 2012 Decision in CTA EB Case No. 734 was penned by Associate Justice Juanito C. Castañeda, Jr. and concurred in by Presiding Justice Ernesto D. Acosta and Associate Justices Erlinda P. Uy, Caesar A. Casanova, Olga Palanca-Enriquez, Esperanza R. Fabon-Victorino and Amelia R. Cotangco-Manalastas of En Banc, Court of Tax Appeals.

denied Cargill Philippines, Inc.'s (Cargill) claim for refund or tax credit worth ₱8,771,270.71, supposedly representing the erroneously paid withholding taxes on royalties from June 1, 2005 to April 30, 2007. The Court of Tax Appeals *En Banc* upheld the First Division's Decision[6] and Resolution,[7] holding that BIR Ruling No. DA-ITAD 60-07 is not binding because the RP-Czech and RP-US tax treaties do not grant similar tax reliefs on royalty payments in violation of the most favored nation clause.

Cargill is a domestic corporation primarily engaged in trading commodities such as copra products, soybeans, and wheat, and in the manufacturing of animal feeds and coconut oil.[8]

On June 1, 2002, Cargill entered into an Intellectual Property License Agreement with United States company CAN Technologies, Inc.[9] (CAN Technologies). The Agreement granted Cargill a "non-exclusive, royalty-bearing, and non-transferable license" to use CAN Technologies' patent, technology, and copyrights "to produce, market, distribute, sell, use and supply animal feeds in the Philippines."[10] In turn, Cargill would pay CAN Technologies a royalty fee equivalent to 1.25% of its net sales and 5.25% of its consulting revenues.[11]

From June 1, 2005 to April 2007, Cargill allegedly paid CAN Technologies ₱175,425,414.12 as royalties, less withholding final taxes at the rate of 15%, or ₱26,313,812.10.[12]

On December 21, 2005, Cargill wrote the Bureau of Internal Revenue, requesting confirmation that the royalties it had paid CAN Technologies were subject to the preferential tax rate of 10% in accordance with the "most favored nation" clause of the RP-US Tax Treaty, in relation to the RP-Bahrain Tax Treaty.[13]

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5 Id. at 76–87. The August 30, 2012 Resolution in CTA EB No. 734 was penned by Associate Justice Juanito C. Castaneda, Jr. and concurred in by Presiding Justice Ernesto D. Acosta and Associate Justices Lovell R. Bautista, Erlinda P. Uy, Caesar A. Casanova, Olga Palanca-Enriquez, Esperanza R. Fabon-Victorino, Cielito N. Mindaro-Grulla and Amelia R. Cotangco-Manalastas of En Banc, Court of Tax Appeals, Quezon City.

6 Id. at 116–132. The September 6, 2010 Decision in CTA Case No. 7656 was penned by Associate Justice Erlinda P. Uy and concurred in by Presiding Justice Ernesto D. Acosta and Associate Justice Esperanza R. Fabon-Victorino of the First Division, Court of Tax Appeals, Quezon City.

7 Id. at 134–143. The February 15, 2011 Resolution in CTA Case No. 7656 was penned by Associate Justice Erlinda P. Uy and concurred in by Presiding Justice Ernesto D. Acosta of the First Division, Court of Tax Appeals, Quezon City.

8 Id. at 14.

9 The company was formerly known as AGX Services, Inc.

10 Id. at 15–16.

11 Id. at 16.

12 Id.

13 Id. at 118. *See* Convention Between the Government of the Republic of the Philippines and the State of Bahrain for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital (2001), available at <https://www.bir.gov.ph/images/bir_files/international_tax_affairs/Bahrain%20treaty.pdf> (last accessed on September 15, 2020).

In reply, the Bureau of Internal Revenue issued BIR Ruling No. DA-ITAD 60-07 on May 11, 2007, confirming that a 10% tax rate may be applied to the royalties Cargill had paid CAN Technologies since January 1, 2004. It did clarify that this was not due to the RP-Bahrain Tax Treaty, which was inapplicable, but Article 12[14] of the RP-Czech Tax Treaty, in relation to Article 13[15] of the RP-US Tax Treaty.[16]

Thus, on July 10, 2007, Cargill filed on behalf of CAN Technologies a claim for refund of ₱8,771,270.71, which it alleged to be the overpaid withholding tax on royalty payments. On the same date, Cargill also filed a Petition before the Court of Tax Appeals, though later submitted an amended Petition.[17]

On September 6, 2010, the Court of Tax Appeals First Division dismissed[18] the Petition for insufficiency of evidence. It held that Cargill failed to show that the taxes imposed on royalties in the RP-US and RP-Czech tax treaties were "paid under similar circumstances" or that the tax reliefs granted to United States residents under the RP-US Tax Treaty, with respect to taxes imposable upon royalties earned from sources within the Philippines, were similar to those allowed to Czech residents under the RP-Czech Tax Treaty.[19]

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[14] Convention Between the Czech Republic and the Republic of the Philippines for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (2000), art. 12 provides:

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 that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed:

a. 10 per cent of the gross amount of the royalties arising from the use of, or the right to use, any copyright of literary, artistic or scientific work, other than that mentioned in sub-paragraph (b), 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;

. . . .

The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations.

[15] Convention Between the Government of the Republic of the Philippines and the Government of the United States of America with Respect to Taxes on Income (1976), art. 13 provides:

Article 13
Royalties

1) Royalties derived by a resident of one of the Contracting State from sources within the other Contracting State may be taxed by both Contracting States.
2) However, the tax imposed by that Contracting State shall not exceed –
a. In the case of the United States, 15% of the gross amount of the royalties, and
b. In the case of the Philippines, the least of:
i. 25 per cent of the gross amount of the royalties;
ii. 15 per cent 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.* (Emphasis supplied)

[16] Id. at 118–119.
[17] Id. at 17–18.
[18] Id. at 116–132.
[19] Id. at 125.

The First Division noted that since Cargill failed to present the relevant provisions of the United States law, it cannot be determined for certain whether the limitation on tax credit under the United States Law was similar to that under the RP-Czech Tax Treaty.[20]

The First Division found BIR Ruling No. DA-ITAD 60-07 infirm in allowing Cargill to apply the 10% preferential tax rate on royalties. It held that the BIR Ruling merely cited the relevant provisions of the tax treaties without explaining how the mechanisms employed by the United States and Czech Republic to mitigate the effects of double taxation are the same.[21]

On September 23, 2010, Cargill filed an Omnibus Motion for Reconsideration and To Reopen the Case for Presentation of Additional Evidence.[22]

In its February 15, 2011 Resolution,[23] the Court of Tax Appeals First Division denied the Omnibus Motion. Citing *Commissioner of Internal Revenue v. S.C. Johnson and Son, Inc.*,[24] it explained that the most favored nation clause aims to grant "*equality of international treatment*," which entails that the tax burden laid on the investor's income be the "*same*" in the two countries. To determine whether there is equality of treatment, the limitations of credit on foreign taxes under the United States Law in relation to Article 23(1) of the RP–US Tax Treaty must be compared with the limitation in Article 22 of the RP-Czech Tax Treaty.[25] As such, Cargill's failure to present the United States Law was deemed fatal to its refund claim. The First Division also reiterated that it was not bound by the BIR Ruling, it being "judicially found to be erroneous."[26]

On March 25, 2011, Cargill filed its Petition for Review before the Court of Tax Appeals *En Banc*.[27]

In a May 24, 2012 Decision,[28] the Court of Tax Appeals *En Banc* dismissed the Petition. It held that Cargill may not avail of the lower 10% tax rate for its failure to comply with the requirements of the most favored nation clause embodied in *S.C. Johnson*, particularly, its failure to show similarity in the circumstances in the payment of taxes on royalties under the

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20 Id. at 130.
21 Id. at 131.
22 Id. at 134.
23 Id. at 134–143.
24 368 Phil. 388 (1999) [Per J. Gonzaga-Reyes, Third Division].
25 *Rollo*, pp. 137–138.
26 Id. at 138–141.
27 Id. at 89 and 92.
28 Id. at 89–114.

two treaties. It also sustained the First Division's holding that BIR Ruling No. DA-ITAD 60-07 cannot be given weight.[29]

Cargill's Motion for Reconsideration was likewise denied in an August 30, 2012 Resolution.[30] Rejecting the argument on its lack of jurisdiction to reverse BIR rulings, the Court of Tax Appeals *En Banc* reasoned that it may pass upon the issue of the validity of an administrative ruling or regulation if raised in refund or assessment cases or other cases where it has jurisdiction.[31]

Hence, Cargill filed this Petition. In turn, the Commissioner of Internal Revenue, through the Office of the Solicitor General, filed a Comment.[32] Cargill subsequently filed its Reply.[33]

Petitioner submits that BIR Ruling No. DA-ITAD 60-07 had confirmed the applicability of the 10% preferential tax rate on the royalties payable by petitioner to CAN Technologies, pursuant to the RP-Czech Tax Treaty in relation to the most favored nation clause of the RP-US Tax Treaty.[34] It adds that, contrary to the holding of the First Division, the BIR Ruling exhaustively explained why the most favored nation rate was applicable,[35] and the ruling was arrived at after the Commissioner had considered all the appropriate laws,[36] supporting documents, and information[37] submitted by petitioner.

Petitioner contends that the BIR Ruling determined that the two conditions laid down in *S.C. Johnson* for the most favored nation clause to apply were met.[38] These conditions were: (1) that royalties derived by a resident of the United States and of Czech Republic are of the same kind;[39] and (2) that the same mechanism must be employed by the United States and Czech Republic in mitigating the effects of double taxation.[40] Petitioner further stresses that before and after BIR Ruling No. DA-ITAD-60-07, the Bureau of Internal Revenue had issued several rulings with the same conclusion.[41] These rulings were presumably supported by factual and legal

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29 Id. at 112.
30 Id. at 76–87.
31 Id. at 85.
32 Id. at 510–538.
33 Id. at 546–572. In compliance with this Court's June 23, 2014 Resolution in relation to the October 22, 2012 Resolution.
34 Id. at 22.
35 Id. at 27–28.
36 Id. at 28.
37 Id. at 31.
38 *Rollo*, p. 22.
39 Id. at 23.
40 Id. at 25.
41 Id. at 29–31. DA ITAD BIR Ruling No. 127-06 dated October 23, 2006; ITAD BIR Ruling No. 152-12 dated March 4, 2012; ITAD BIR Ruling No. 073-12 dated February 16, 2012; ITAD BIR Ruling No. 126-11 dated April 5, 2011; ITAD BIR Ruling No. 070-11 dated March 1, 2011; ITAD BIR Ruling No. 045-10 dated March 5, 2010; ITAD BIR Ruling No. 041-10 dated September 21, 2010; ITAD BIR Ruling No. 019-10 dated August 20, 2010.

bases, and petitioner argues that these must be respected.[42]

Moreover, petitioner submits that the Court of Tax Appeals had no jurisdiction to reverse BIR Ruling No. DA-ITAD-60-07.[43] It invokes *British American Tobacco v. Camacho*,[44] which had ruled that the Court of Tax Appeals' jurisdiction does not include cases where the constitutionality of a law or rule is challenged. It submits that the BIR Ruling remains valid until the Commissioner of Internal Revenue or the regular courts revoke it.[45] Neither can it be attacked collaterally in the present tax refund case.[46]

Even if BIR Ruling No. DA-ITAD-60-07 were invalid, petitioner contends that such invalidity cannot be applied retroactively to its prejudice.[47]

Petitioner then argues that the preferential 10% tax rate would still apply despite certain dissimilarities.[48] For one, even if the RP-Czech Tax Treaty allows tax credit to a *resident*, while the RP-US Tax Treaty allows tax credit to a *resident and citizen*, the most favored nation clause still applies. What is important is that residents of both states are entitled to the similar tax reliefs for taxes paid in the Philippines.[49] Similarly, even if the RP-Czech Tax Treaty allows tax credit on royalties *paid* in the Philippines, while the RP-US Tax Treaty allows tax credit on royalties *paid or accrued* in the Philippines, the clause would still apply.[50]

Petitioner also submits that a reference to United States laws is not necessary for the most favored nation clause to apply.[51] It adds that in *S.C. Johnson*, this Court did not consider the domestic laws of the United States and Germany in determining if the taxes are "paid under similar circumstances."[52] In that case, asserts petitioner, the tax credit allowed under the RP-US and RP-Germany tax treaties were considered, and not the tax credit ultimately granted under each country's domestic law.[53]

Petitioner adds that "since the . . . royalties involved refer to royalties in the Philippines, the taxes on royalties referred to . . . pertains to the taxes paid in the Philippines based on the treaties and not the taxes paid in the country where the recipient of the royalty income is a resident."[54] Petitioner

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42 Id. at 31–32.
43 Id. at 32.
44 584 Phil. 489 (2008) [Per J. Ynares-Santiago, En Banc].
45 *Rollo*, p. 32.
46 Id. at 33–34.
47 Id. at 35.
48 Id. at 39.
49 Id. at 40–41.
50 Id. at 42–43.
51 Id. at 44.
52 Id. at 50.
53 Id. at 49–50.
54 Id. at 50–51.

submits that:

> . . . the taxes on royalties under both the RP-US Tax Treaty and the RP-Czech Tax Treaty are paid under similar circumstances, considering that the taxes paid on such royalties in the Philippines are allowed as tax credit from the tax due on such income imposed in the United States and on the taxes due on such income imposed in the Czech Republic.[55]

Finally, petitioner insists on being entitled to the refund of ₱8,771,270.71, the amount it claims to represent the erroneously paid final withholding taxes on royalties paid to CAN Technologies.[56]

In her Comment, respondent counters that the Court of Tax Appeals has jurisdiction to pass upon the validity of BIR Ruling No. DA-ITAD 60-07, as petitioner's claim for refund hinges on this issue.[57]

Respondent goes on to claim that the Court of Tax Appeals correctly ruled that BIR Ruling No. DA-ITAD 60-07 is not valid because the second requirement of the most favored nation clause, per *S.C. Johnson*, was not met.[58] Petitioner allegedly failed to show similarity in the circumstances in the payment of taxes on royalties under the two treaties.[59]

Respondent also asserts that petitioner failed to present evidence to establish the provisions of the United States law that determines the limitation of the amount that may be credited, as referred to in Article 23(1) of the RP-US Tax Treaty.[60]

Finally, respondent claims that BIR Ruling No. DA-ITAD 60-07 must be struck down because it goes against the rule in *S.C. Johnson* for the most favored nation clause to apply.[61] She maintains that "administrative regulations 'may not enlarge, alter, or restrict the provisions of the law it administers.'"[62]

In its Reply, petitioner reiterates the arguments it raised in its Petition. It maintains that even if BIR Ruling No. DA-ITAD 60-07 were invalid, the ruling should not be retroactively applied to its prejudice.[63]

Petitioner further avers that the differences on entities entitled to tax

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55 Id. at 54.
56 Id.
57 Id. at 517.
58 Id. at 522.
59 Id. at 525.
60 Id. at 528.
61 Id. at 531.
62 Id.
63 Id. at 547–548.

credit[64] and on the timing of tax credit recognition do not amount to dissimilarities in the circumstances of the payment of the tax, and thus, would not render the most favored nation clause inapplicable.[65] It also submits that limitations on tax credit are present in both the RP-US Tax Treaty and RP-Czech Tax Treaty. It disagrees with respondent's position that reference to domestic laws on the determination of the amount of foreign tax credit would result in a dissimilarity in the circumstances of the payment of the taxes.[66]

Petitioner asserts that limitations on tax credit are common features in tax treaties. Citing the OECD Model Tax Convention and its commentaries, petitioner avers that a number of treaties usually refer to the domestic laws of the contracting states for detailed rules on foreign tax credit. This is permissible, adds petitioner, as long as the general principle laid down in Article 23B of the OECD Model is not altered. The general principle is that the tax credit of foreign income taxes imposed on foreign source income is limited to the extent that such taxes do not exceed the income tax of the other country on that foreign source income.[67]

Petitioner submits that since both the RP-US and RP-Czech tax treaties provide the general principle on limitation on tax credit, there is similarity in the circumstances of payment of taxes.[68] There is no need to delve into the details of the United States law, which merely concerns the calculation of the limitation on tax credit. Petitioner adds that the Philippines had likewise placed similar conditions and references to domestic law in the tax treaties.[69]

Invoking the doctrine of *processual presumption*, petitioner further argues that the United States income tax law is presumed to be the same as Philippine tax law. It contends that Section 904(a) of the United States Internal Revenue Code is similar to Section 34(c)(4) of the National Internal Revenue Code of 1997, as amended.[70]

Finally, petitioner submits that tax treaties are governed by international law, and they should be interpreted in good faith in light of their object and purpose, pursuant to the general rules of interpretation set forth in the Vienna Convention on the Law of Treaties. It then asserts that the Court of Tax Appeals' ruling—that the second requisite of the most favored nation clause was not met—was not made in good faith and does not serve the object and purpose of the tax treaties. Petitioner argues that such strict construction negates the essence of the most favored nation clause,

[64] Id. at 549.
[65] Id. at 551–552.
[66] Id. at 552.
[67] Id. at 552–554.
[68] Id. at 556.
[69] Id. at 556–558.
[70] Id. at 561–563.

which is to ensure equality in international treatment, and the availment of the reliefs provided in the tax treaties.[71]

For this Court's resolution are the following issues:

First, whether or not the Court of Tax Appeals has jurisdiction to determine the validity of BIR Ruling No. DA-ITAD 60-07. Related to this is whether or not the validity of BIR Ruling No. DA-ITAD 60-07 can be assailed in the present tax refund case;

Second, whether or not the Court of Tax Appeals erred in declaring BIR Ruling No. DA-ITAD 60-07 invalid and not binding;

Third, whether or not the Court of Tax Appeals' ruling declaring BIR Ruling No. DA-ITAD 60-07 to be invalid can be applied to petitioner; and

Finally, whether or not petitioner is entitled to a tax refund/credit certificate in the amount of ₱8,771,270.71, representing erroneously paid final withholding taxes on royalties paid to CAN Technologies from June 1, 2005 to April 30, 2007.

The Petition is denied.

I

The Court of Tax Appeals has jurisdiction to review and nullify the rulings of the Commissioner of Internal Revenue.

Under Republic Act No. 1125, or An Act Creating the Court of Tax Appeals, as amended by Republic Act No. 9282, the Commissioner of Internal Revenue's rulings on "other matters arising under the National Internal Revenue or other laws administered by the Bureau of Internal Revenue" are appealable to the Court of Tax Appeals, thus:

> SECTION 7. *Jurisdiction.* — The CTA shall exercise:
>
> a. *Exclusive appellate jurisdiction to review by appeal,* as herein provided:
>
> 1. *Decisions of the Commissioner of Internal Revenue in* cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or other *matters arising under the National Internal Revenue or*

[71] Id. at 564–566.

other laws administered by the Bureau of Internal Revenue[.]

Here, petitioner argues that the Court of Tax Appeals had no jurisdiction to reverse or nullify BIR Ruling No. DA-ITAD-60-07, citing *British American Tobacco v. Camacho*,[72] which held:

> While the above statute confers on the CTA jurisdiction to resolve tax disputes in general, this does not include cases where the constitutionality of a law or rule is challenged. *Where what is assailed is the validity or constitutionality of a law, or a rule or regulation issued by the administrative agency in the performance of its quasi-legislative function, the regular courts have jurisdiction to pass upon the same. The determination of whether a specific rule or set of rules issued by an administrative agency contravenes the law or the constitution is within the jurisdiction of the regular courts. Indeed, the Constitution vests the power of judicial review or the power to declare a law, treaty, international or executive agreement, presidential decree, order, instruction, ordinance, or regulation in the courts, including the regional trial courts.* This is within the scope of judicial power, which includes the authority of the courts to determine in an appropriate action the validity of the acts of the political departments. Judicial power includes the duty of the courts of justice to settle actual controversies involving rights which are legally demandable and enforceable, and to determine whether or not there has been a grave abuse of discretion amounting to lack or excess of jurisdiction on the part of any branch or instrumentality of the Government.[73] (Emphasis supplied)

We disagree.

In *The City of Manila v. Hon. Grecia-Cuerdo*,[74] this Court recognized that the Court of Tax Appeals possessed all inherent powers necessary to the full and effective exercise of its appellate jurisdiction over tax cases:

> A grant of appellate jurisdiction implies that there is included in it the power necessary to exercise it effectively, to make all orders that will preserve the subject of the action, and to give effect to the final determination of the appeal. It carries with it the power to protect that jurisdiction and to make the decisions of the court thereunder effective. The court, in aid of its appellate jurisdiction, has authority to control all auxiliary and incidental matters necessary to the efficient and proper exercise of that jurisdiction. For this purpose, it may, when necessary, prohibit or restrain the performance of any act which might interfere with the proper exercise of its rightful jurisdiction in cases pending before it.
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> Lastly, it would not be amiss to point out that a court which is endowed with a particular jurisdiction should have powers which are necessary to enable it to act effectively within such jurisdiction. These should be regarded as powers which are inherent in its jurisdiction and the

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72 584 Phil. 489 (2008) [Per J. Ynares-Santiago, En Banc].

73 Id. at 511.

74 726 Phil. 9 (2014) [Per J. Peralta, En Banc].

> court must possess them in order to enforce its rules of practice and to suppress any abuses of its process and to defeat any attempted thwarting of such process.
>
> *In this regard, Section 1 of RA 9282 states that the CTA shall be of the same level as the CA and shall possess all the inherent powers of a court of justice.*
>
> *Indeed, courts possess certain inherent powers which may be said to be implied from a general grant of jurisdiction, in addition to those expressly conferred on them. These inherent powers are such powers as are necessary for the ordinary and efficient exercise of jurisdiction; or are essential to the existence, dignity and functions of the courts, as well as to the due administration of justice; or are directly appropriate, convenient and suitable to the execution of their granted powers; and include the power to maintain the court's jurisdiction and render it effective in behalf of the litigants.*
>
> *Thus, this Court has held that "while a court may be expressly granted the incidental powers necessary to effectuate its jurisdiction, a grant of jurisdiction, in the absence of prohibitive legislation, implies the necessary and usual incidental powers essential to effectuate it, and, subject to existing laws and constitutional provisions, every regularly constituted court has power to do all things that are reasonably necessary for the administration of justice within the scope of its jurisdiction and for the enforcement of its judgments and mandates." Hence, demands, matters or questions ancillary or incidental to, or growing out of, the main action, and coming within the above principles, may be taken cognizance of by the court and determined, since such jurisdiction is in aid of its authority over the principal matter, even though the court may thus be called on to consider and decide matters which, as original causes of action, would not be within its cognizance.*[75] (Emphasis supplied, citations omitted)

This Court underscored that the grant of appellate jurisdiction to the Court of Tax Appeals includes the power necessary to exercise it effectively. Deemed included in its jurisdiction is the authority to resolve petitions for certiorari against interlocutory orders of the Regional Trial Court in local tax cases.[76] Furthermore, a split jurisdiction between the Court of Tax Appeals and the Court of Appeals is "anathema to the orderly administration of justice" and could not have been the legislative intent.[77]

In *Banco De Oro v. Republic*,[78] this Court abandoned *British American Tobacco* and declared that the Court of Tax Appeals has exclusive jurisdiction to determine the validity of tax laws, rules and regulations, and other administrative issuances of the Commissioner of Internal Revenue. Consistent with *Commissioner of Internal Revenue v. Leal*,[79] citing

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[75] Id. at 26–28.
[76] Id. at 28.
[77] Id. at 25.
[78] 793 Phil. 97 (2016) [Per J. Leonen, En Banc].
[79] 440 Phil. 477 (2002) [Per Sandoval-Gutierrez, Third Division].

Rodriguez v. Blaquera[80] and *Asia International Auctioneers, Inc. v. Hon. Parayno, Jr.*,[81] we recognized the Court of Tax Appeals' broad authority over tax-related cases. Thus:

> *The Court of Tax Appeals has undoubted jurisdiction to pass upon the constitutionality or validity of a tax law or regulation when raised by the taxpayer as a defense in disputing or contesting an assessment or claiming a refund. It is only in the lawful exercise of its power to pass upon all matters brought before it, as sanctioned by Section 7 of Republic Act No. 1125, as amended.*
>
> *This Court, however, declares that the Court of Tax Appeals may likewise take cognizance of cases directly challenging the constitutionality or validity of a tax law or regulation or administrative issuance (revenue orders, revenue memorandum circulars, rulings).*
>
> Section 7 of Republic Act No. 1125, as amended, is explicit that, except for local taxes, appeals from the decisions of quasi-judicial agencies (Commissioner of Internal Revenue, Commissioner of Customs, Secretary of Finance, Central Board of Assessment Appeals, Secretary of Trade and Industry) on tax-related problems must be brought *exclusively* to the Court of Tax Appeals.
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> In other words, within the judicial system, the law intends the Court of Tax Appeals to have exclusive jurisdiction to resolve all tax problems. Petitions for writs of certiorari against the acts and omissions of the said quasi-judicial agencies should, thus, be filed before the Court of Tax Appeals.
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> Republic Act No. 9282, a special and later law than Batas Pambansa Blg. 129 provides an exception to the original jurisdiction of the Regional Trial Courts over actions questioning the constitutionality or validity of tax laws or regulations. Except for local tax cases, actions directly challenging the constitutionality or validity of a tax law or regulation or administrative issuance may be filed directly before the Court of Tax Appeals.
>
> Furthermore, with respect to administrative issuances (revenue orders, revenue memorandum circulars, or rulings), these are issued by the Commissioner under its power to make rulings or opinions in connection with the implementation of the provisions of internal revenue laws. Tax rulings, on the other hand, are official positions of the Bureau on inquiries of taxpayers who request clarification on certain provisions of the National Internal Revenue Code, other tax laws, or their implementing regulations. Hence, the determination of the validity of these issuances clearly falls within the exclusive appellate jurisdiction of the Court of Tax Appeals under Section 7(1) of Republic Act No. 1125, as amended, subject to prior review by the Secretary of Finance, as required under Republic Act No. 8424.[82] (Emphasis supplied, citations omitted)

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80 109 Phil. 598 (1960) [Per J. Concepcion, En Banc].

81 565 Phil. 255 (2007) [Per C.J. Puno, First Division].

82 *Banco De Oro v. Republic*, 793 Phil. 97, 123–125 (2016) [Per J. Leonen, En Banc].

Banco de Oro stressed that such jurisdiction is exclusively vested in the Court of Tax Appeals, whether raised by the taxpayer directly or as a defense.

Thus, the Court of Tax Appeals has jurisdiction to pass upon the validity of BIR Ruling No. DA-ITAD-60-07, on which petitioner squarely relied to support its claim for refund. The Court of Tax Appeals is not bound by the Bureau of Internal Revenue's interpretation or application of treaty provisions when it is found to be clearly erroneous. As this Court held:

> Even conceding that the construction of a statute by the CIR is to be given great weight, the courts, which include the CTA, are not bound thereby if such construction is erroneous or is clearly shown to be in conflict with the governing statute or the Constitution or other laws. "It is the role of the Judiciary to refine and, when necessary, correct constitutional (and/or statutory) interpretation, in the context of the interactions of the three branches of the government."[83] (Citation omitted)

II

The main substantive issue raised in this case involves the application of the most favored nation clause under Article 13(2)(b)(iii) of the RP-US Tax Treaty,[84] a convention between the Philippines and the United States. The provision states:

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 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***

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83 *Commissioner of Internal Revenue v. Philippine Airlines, Inc.*, 609 Phil. 695, 724 (2009) [Per J. Chico-Nazario, Third Division].

84 The Convention between the Government of the Republic of the Philippines and the Government of the United States of America with respect to Taxes on Income was signed in Manila on October 1, 1976. It entered into force on October 16, 1982, the 30th day following the exchange of the relevant instruments of ratification in Washington, United States on September 16, 1982. Its provisions on taxes apply on income derived or which accrued beginning January 1, 1983.

> ***circumstances*** *to a resident of a third State.* (Emphasis supplied)

The most favored nation clause speaks of 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.*" Therefore, the tax treatment of royalties to a United States entity may be taken in relation to other tax treaties that provide a lower tax rate on the same type of income.

Here, the question is whether petitioner is entitled to the 10% preferential tax rate, as provided in Article 12(2)(a) of the RP-Czech Tax Treaty,[85] on royalties paid to CAN Technologies, a resident corporation of the United States:

> 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 that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, *the tax so charged **shall not exceed*** –
>
> a. *10 per cent of the gross amount of the royalties* arising from the use of, or the right to use, any copyright of literary, artistic or scientific work, other than that mentioned in sub-paragraph (b), 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;
>
> . . . .
>
> The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. (Emphasis supplied)

In *Commissioner of Internal Revenue v. S.C. Johnson & Sons*,[86] this Court construed the phrase "paid under similar circumstances" under the most favored nation clause as referring to *circumstances that are tax-related.* In other words, the *similarity in the circumstances of payment of taxes on the royalties derived from the Philippines is a condition for the enjoyment of the most favored nation treatment.*

[85] The Convention between the Czech Republic and the Republic of the Philippines for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income was signed in Manila on November 13, 2000. It became effective on January 1, 2004.

[86] 368 Phil. 388 (1999) [Per J. Gonzaga-Reyes, Third Division].

This Court explained in *S.C. Johnson* that bilateral tax treaties have been entered into by the Philippines with different countries to avoid double taxation. It held:

> The purpose of these international agreements is to reconcile the national fiscal legislations of the contracting parties in order to help the taxpayer avoid simultaneous taxation in two different jurisdictions. 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. The apparent rationale for doing away with double taxation is to encourage the free flow of goods and services and the movement of capital, technology and persons between countries, conditions deemed vital in creating robust and dynamic economies. Foreign investments will only thrive in a fairly predictable and reasonable international investment climate and the protection against double taxation is crucial in creating such a climate.[87] (Emphasis in the original, citations omitted)

This Court further explained that to eliminate double taxation, a tax treaty resorts to two methods: *first*, by allocating the right to tax between the contracting states; and *second*, where the state of source is assigned the right to tax, by requiring the state of residence to grant a tax relief either through exemption or tax credit. Thus:

> Double taxation usually takes place when a person is 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. In order to eliminate double taxation, a tax treaty resorts to several methods. First, it sets out the respective rights to tax of the state of source or situs and of the state of residence with regard to certain classes of income or capital. In some cases, an exclusive right to tax is conferred on one of the contracting states; however, for other items of income or capital, both states are given the right to tax, although the amount of tax that may be imposed by the state of source is limited.
>
> The second method for the elimination of double taxation applies whenever the state of source is given a full or limited right to tax together with the state of residence. In this case, the treaties make it incumbent upon the state of residence to allow relief in order to avoid double taxation. *There are two methods of relief — the exemption method and the credit method. In the* ***exemption method, the income or capital which is taxable in the state of source or situs is exempted in the state of residence, although in some instances it may be taken into account in determining the rate of tax applicable to the taxpayer's remaining income or capital.*** *On the other hand, in the* ***credit method, although the income or capital which is taxed in the state of source is still taxable in the state of residence, the tax paid in the former is credited against the tax levied in the latter.*** *The basic difference between the two methods is that in the exemption method, the focus is on the income or capital itself,*

[87] Id. at 404–405.

whereas the credit method focuses upon the tax.[88] (Emphasis supplied, citations omitted)

The exemption and credit principles are the two leading principles in eliminating double taxation that are being followed in existing conventions between countries.[89]

Under the exemption principle, the income that may be taxed in the state of source is not taxed in the state of residence. This may be applied by two methods: *full exemption*, where the state of residence does not account for the income from the state of source for tax purposes; or *with progression*, where the income taxed in the state of source is not taxed by the state of residence, but the state of residence retains the right to consider that income when determining the tax to be imposed on the rest of the income.[90]

Under the credit principle, the state of residence retains the right to tax the taxpayer's total income, but allows a deduction for the tax paid in the state of source. It may be applied by two methods: a *full credit*, where the total amount of tax paid in the state of source is allowed as deduction; or an *ordinary credit*, where the deduction allowed by the state of residence is restricted to that part of its own tax appropriate to the income from the state of source.[91]

Some states have also adopted the so-called "*tax sparing*"[92] provision,

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[88] Id. at 405–406.

[89] Commentary on Article 23A and 23B of the OECD Model: Concerning the Methods for Elimination of Double Taxation, 8, available at <https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_59d66429-en#page9> (last accessed on September 8, 2020). The Organization for Economic Cooperation and Development (OECD) Model Double Taxation Conventions constituted as the principal bases for bilateral treaty negotiations among developed nations. The US' model income tax convention was also based to a large degree on the OECD Model. *See* Robert Thornton Smith, *Tax Treaty Interpretation by the Judiciary,* 49 THE TAX LAWYER 845–891 (1996), available at *<https://www.jstor.org/stable/20771815?refreqid=excelsior%3Af1e1bc19b78581d03babe8c48d68a7eb&seq=1>* (last accessed on September 8, 2020).

[90] Commentary on Article 23A and 23B of the OECD Model: Concerning the Methods for Elimination of Double Taxation, 8, available at <https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_59d66429-en#page9> (last accessed on September 8, 2020).

[91] Id.

[92] *See for instance* Article 24 of RP-India Tax Treaty; Article 23(3) of the RP-Vietnam Tax Treaty. An example of tax sparing is found in the TAX CODE, Section 28(B)(5)(b), in relation to dividend income earned by a foreign investor in the Philippines. The provision states:
SEC. 28. Rates of Income Tax on Foreign Corporations. –

. . . .

(B) *Tax on Nonresident Foreign Corporation.* –

. . . .

(5) *Tax on Certain Incomes Received by a Nonresident Foreign Corporation.* –

. . . .

(b) *Intercorporate Dividends.* – A final withholding tax at the rate of fifteen percent (15%) is hereby imposed on the amount of cash and/or property dividends received from a domestic corporation, which shall be collected and paid as provided in Section 57(A) of this Code, *subject to the condition that the country in which the nonresident foreign corporation is domiciled, shall allow a credit against the tax due from the nonresident foreign corporation taxes deemed to have been paid in the Philippines equivalent to twenty percent (20%),* which represents the difference between the regular income tax of thirty-five percent (35%) and the fifteen percent (15%) tax on dividends as in relation to tax incentives granted under their respective domestic laws to attract foreign investments.[93] With tax sparing, taxes exempted or reduced are considered fully paid.[94] Consequently, a non-resident may obtain a tax credit for the taxes that have been "*spared*" under the incentive program of the state of source,[95] preserving the economic benefits granted by the state of source.

Another form of tax sparing is the so-called "matching credit,"[96]

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provided in this subparagraph: *Provided,* That effective January 1, 2009 the credit against the tax due shall be equivalent to fifteen percent (15%), which represents the difference between the regular income tax of thirty percent (30%) and the fifteen percent (15%) tax on dividends[.]

See Commissioner of Internal Revenue v. Procter & Gamble Phil. Manufacturing Corp., 243 Phil. 703 (1988) [Per J. Paras, Second Division].

93 Commentary on Article 23A and 23B of the OECD Model: Concerning the Methods for Elimination of Double Taxation, p. 8, available at <https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_59d66429-en#page9> (last accessed on September 8, 2020).

94 J. Paras, Dissenting Opinion in *Commissioner of Internal Revenue v. Procter & Gamble Philippines Manufacturing Corp.,* 281 Phil. 425, 465–476 (1991) [Per J. Feliciano, En Banc].

95 Commentary on Article 23A and 23B of the OECD Model: Concerning the Methods for Elimination of Double Taxation, p. 8, available at <https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_59d66429-en#page9> (last accessed on September 8, 2020).

An example of a tax sparing provision is found in Article 23 in relation to Article 12 of the RP-New Zealand Tax Treaty, which provides:

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 law of that State, but if the recipient is the beneficial owner of the royalties, the tax so charged shall not exceed:

a) in the case of New Zealand, 15 percent of the gross amount of the royalties; and
b) in the case of the Philippines,
   (i) *15 percent of the gross amount of the royalties where the royalties are paid by an enterprise registered with the Philippine Board of Investments and engaged in preferred areas of activities*; and
   (ii) in all other cases, 25 percent of the gross amount of the royalties.

Article 23
RELIEF FROM DOUBLE TAXATION

Double taxation shall be avoided in the following manner:

. . . .

2. In the case of New Zealand:

Subject to any provisions of the law of New Zealand which may from time to time be in force and which relate to the allowance of a credit against New Zealand tax of tax paid in a country outside New Zealand (which shall not affect the general principle hereof), Philippine tax paid under the law of the Philippines and consistently with this Convention, whether directly or by deduction, in respect of income derived by a New Zealand resident from sources in the Philippines (excluding, in the case of a dividend, tax paid in respect of the profits out of which the dividend is paid) shall be allowed as a credit against New Zealand tax payable in respect of that income. . . *Where, in terms of paragraph 2(b)(i) of Article 12, a resident of New Zealand derives income from royalties which are paid by an enterprise registered with the Philippine Board of Investments and engaged in preferred areas of activity he shall be deemed to have paid in addition to the Philippine tax actually paid, Philippine tax in an amount equal to 10 percent of the gross amount of the royalties.* (Emphasis supplied)

96 For instance, Article 23(2) of the RP-Brazil Tax Treaty provides:

Article 23
METHODS FOR THE ELIMINATION OF DOUBLE TAXATION

1. Where a resident of a Contracting State derives income which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first Contracting State shall allow as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in the other Contracting State.

   The deduction shall not, however, exceed that part of the income tax as computed before the deduction is given, which is appropriate to the income which may be taxed in the other Contracting State.

where the state of residence agrees, as a counterpart to the reduced tax, to allow a deduction against its own tax of an amount fixed at a higher rate.[97]

In *S.C. Johnson*, this Court stated that "[i]n negotiating tax treaties, the underlying rationale for reducing the tax rate is that the Philippines will give up a part of the tax in the expectation that the tax given up for this particular investment is not taxed by the other country."[98] It expounded:

> . . . the ultimate reason for avoiding double taxation is to encourage foreign investors to invest in the Philippines — a crucial economic goal for developing countries. The goal of double taxation conventions would be thwarted if such treaties did not provide for effective measures to minimize, if not completely eliminate, the tax burden laid upon the income or capital of the investor. Thus, if the rates of tax are lowered by the state of source, in this case, by the Philippines, there should be a concomitant commitment on the part of the state of residence to grant some form of tax relief, whether this be in the form of a tax credit or exemption. Otherwise, the tax which could have been collected by the Philippine government will simply be collected by another state, defeating the object of the tax treaty since the tax burden imposed upon the investor would remain unrelieved. If the state of residence does not grant some form of tax relief to the investor, no benefit would redound to the Philippines, *i.e.*, increased investment resulting from a favorable tax regime, should it impose a lower tax rate on the royalty earnings of the investor, and it would be better to impose the regular rate rather than lose much-needed revenues to another country.[99] (Citations omitted)

In light of the purpose of tax treaties, the relevant treaty provisions on the tax treatment of particular items of income, combined with the provision on the elimination or avoidance of double taxation, govern the allocation of the right to tax between the contracting states.

In some tax treaties or international agreements, a most favored nation clause is added to ensure the contracting states of the benefit of concessions previously or subsequently to be made by either contracting state. This provision guards against oversight during treaty negotiation, and obviates the need for subsequent negotiations.[100] The clause aims to prevent

2. For the deduction indicated in paragraph 1, the Brazilian tax and the Philippine tax shall always be deemed to have been paid at the rate of 25 per cent in the following cases:

a) dividends referred to in paragraph 2 of Article 10;

b) interest referred to in paragraph 2 of Article11; and

c) royalties referred to in paragraph 2 of Article 12.

97 Commentary on Article 23A and 23B of the OECD Model: Concerning the Methods for Elimination of Double Taxation, p. 8, available at <https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_59d66429-en#page9> (last accessed on September 8, 2020).

98 *Commissioner of Internal Revenue v. S.C. Johnson and Son, Inc.*, 368 Phil. 388, 406 (1999) [Per J. Gonzaga-Reyes, Third Division].

99 Id. at 409–410.

100 *The Most Favoured Nation Clause,* 22 THE AMERICAN JOURNAL OF INTERNATIONAL LAW, 133–156 (1928). Available at <https://www.jstor.org/stable/2213313> (last accessed on September 8, 2020).

discriminations[101] and to give assurance of the opportunity to enjoy equality of treatment.[102] In *S.C. Johnson*:

> 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 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% for 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.[103] (Citations omitted)

Per *S.C. Johnson*, two conditions must be met for the most favored nation clause to apply. *First*, royalties derived from the Philippines by a resident of the United States and of the third state must be of the same kind or class, in order to avail of the lower tax enjoyed by the third state. *Second*, the tax consequences of royalty payments under the two treaties must be under similar circumstances. This requires a showing that the method employed for eliminating or mitigating the effects of double taxation under the treaty with the United States and the third state are the same.

In that case, this Court found that the United States resident was not entitled to the most favored nation tax rate of 10% on royalty income derived from the Philippines because the payment of such tax was not under similar circumstances. While Germany has a matching credit of 20% of the gross amount of royalties paid in the Philippines, there is no such similar credit granted by the United States.[104]

Here, there is no question as to compliance with the first condition. It is undisputed that payments to CAN Technologies for the use or entitlement to use its patent, technology, and copyrights on the manufacture and sale of

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101 *See Commissioner of Internal Revenue v. Philippine Ace Lines, Inc.*, 134 Phil. 874 (1968) [Per J. Angeles, En Banc].

102 *See Commissioner of Internal Revenue v. S.C. Johnson and Son, Inc.*, 368 Phil. 388 (1999) [Per J. Gonzaga-Reyes, Third Division].

103 Id. at 410–411.

104 Id. at 411.

animal feeds are within the definition of royalties under Article 13(3)[105] of the RP-US Tax Treaty and Article 12(2)[106] of the RP-Czech Tax Treaty.

On the second condition, this Court agrees with petitioner that differences pertaining to the taxpayers entitled to tax credit (*resident and citizen* under RP-US Tax Treaty vs. *resident* under RP-Czech Tax Treaty) and to the timing of the recognition of the tax credit (taxes *paid or accrued* under RP-US Tax Treaty vs. taxes *paid* under RP-Czech Tax Treaty) do not amount to dissimilarities in the circumstances of the payment of the tax, which would have rendered the most favored nation clause inapplicable.[107]

As petitioner argued, the inclusion of "citizens" under the RP-US Tax Treaty is not a material distinguishing feature. What is important is that residents of both the United States and the Czech Republic are entitled to similar tax reliefs for taxes paid in the Philippines. Similarly, that taxes "paid or accrued" are allowed as tax credit under the RP-US Tax Treaty pertains merely to the timing of recognition of the credit, which depends on when the tax was levied at the state of source. Regardless, under the tax treaties, relief is required to be granted by the state of residence where an item of income is taxed by the state of source.

However, we find untenable petitioner's contention on the similarity of tax reliefs allowed by the United States and the Czech Republic. Both the RP-US Tax Treaty and the RP-Czech Tax Treaty were entered into "for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income."[108] The articles for the elimination or avoidance

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105 Convention Between the Government of the Republic of the Philippines and the Government of the United States of America with Respect to Taxes on Income (1976), art. 13 provides:

Article 13
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 cinematographic films or films or tapes used for radio or television broadcasting, *any patent, trademark, 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)

106 Convention Between the Czech Republic and the Republic of the Philippines for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (2000), art. 12 provides:

Article 12
Royalties

1) . . . .
2) However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed –

a. 10% of the gross amount of the royalties arising from the use of, or the right to use, any copyright of literary, artistic or scientific work, other than that mentioned in sub-paragraph (b), *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[.]* (Emphasis supplied)

107 *Rollo*, pp. 40–43.

108 The prefatory clauses of both treaties uniformly state this.

of double taxation of both countries are found in the following provisions in the RP-US Tax Treaty and RP-Czech Tax Treaty:

RP-US Tax Treaty	**RP-Czech 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 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 of 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	Article 22 ELIMINATION OF DOUBLE TAXATION 1. In the case of a resident of 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 the Philippine tax of tax paid in any country other than the Philippines, the Czech tax paid in respect of income derived from the Czech Republic shall be allowed as credit against the Philippine tax payable in respect of that income. 2. In the case of a resident of the Czech Republic, double taxation shall be eliminated as follows: a) The Czech Republic, when imposing taxes on its residents, may include in the tax base upon which such taxes are imposed the items of income which according to the provisions of this Convention may also be taxed in the Philippines, but shall allow as a deduction from the amount of tax computed on such a base *an amount equal to the tax paid in the Philippines. Such deduction shall not, however, exceed that part of the Czech tax, as computed before the deduction is given, which is appropriate to the income which, in accordance with the provisions of this Convention, may be taxed in the Philippines.* b) Where in accordance with any provision of the Convention income derived by a resident of the Czech Republic is exempt from tax in the Czech Republic, the Czech Republic may nevertheless, in calculating the amount of Czech tax on the remaining income of such resident, take into account the exempted income.

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 . . . 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 Philippine law for the taxable year[.] (Emphasis supplied)	(Emphasis supplied)

Indeed, both the United States and the Czech Republic adopt the credit principle, where the taxes paid in the Philippines on royalty income are allowed to be credited against the United States tax or Czech tax, as the case may be. However, a closer look at the treaty provisions would show that while the RP-Czech Tax Treaty specifies how the tax credit is to be implemented and its limitations, the RP-US Tax Treaty does not.

By looking at the RP-Czech Tax Treaty, we would already know how the credit is applied and what the maximum deduction allowed is:

First, the Czech tax is calculated based on the taxpayer's total income, including the income from the Philippines, but the tax paid in the Philippines is allowed as deduction from the Czech tax; and

Second, the *tax paid in the Philippines should not exceed the Czech tax appropriate to the Philippine-sourced income.*

On the other hand, while the RP-US Tax Treaty does not provide details on how the credit is to be applied and its limitations, it expressly refers to the United States law in that the tax paid or accrued to the Philippines shall be allowed as a credit against United States tax *in accordance with, and subject to the limitations of United States law.* Furthermore, the *tax credit shall not exceed the limitations provided by the United States law for the taxable year.*

Moreover, under the RP-Czech Tax Treaty, the limitation on credit is already specified—that the Philippine tax should not exceed the Czech tax payable for the same income. Under the RP-US Tax Treaty, the limitation on credit is not determinable unless we look into the internal tax law of the United States.

Therefore, the Court of Tax Appeals was correct in ruling that the relevant provisions of the United States law are necessary to determine for certain the similarity in circumstances in the payment of taxes on royalty in the United States and the Czech Republic.

In this regard, the Court of Tax Appeals First Division, as reiterated by the *En Banc*, made the following findings:

> Records show that petitioner failed to present evidence to prove or establish the provisions of the United States law which would determine the limitation being referred to in Article 23(1) of the RP-US Tax Treaty. Thus, We cannot say for certain that the RP-US Tax Treaty grants similar tax reliefs to residents of the United States with respect to taxes imposable upon royalties earned from sources within the Philippines as those allowed to Czech residents under the RP-Czech Tax Treaty.
>
> The limitation of the amount that may be credited under the RP-US Tax Treaty must be clearly established. This must be so because 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.[109] (Citation omitted)

Petitioner, however, invokes the doctrine of *processual presumption*, which provides that "in the absence of pleading and proof, the laws of the foreign country or state will be presumed to be the same as our local or domestic law."[110] It argues that the limitation on credit may then be clearly established by referring to our domestic law, which is presumed to be the same as the United States law on the matter. It adds that Section 904(a) of the United States Internal Revenue Code is similar to Section 34(c)(4) of the National Internal Revenue Code of 1997, as amended.[111]

This Court is not convinced.

The International law doctrine of *processual presumption* or *presumed-identity approach* comes into play when a party invoking the application of a foreign law to a dispute fails to prove the foreign law.[112] While the doctrine has been applied in cases involving common carriers,[113] property relations of spouses,[114] maritime[115] and labor,[116] it is not applicable

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[109] *Rollo*, p. 130.

[110] Id. at 561.

[111] Id. at 561–562.

[112] *EDI-Staffbuilders International, Inc. v. National Labor Relations Commission*, 563 Phil. 1, 22 (2007) [Per J. Velasco, Jr., Second Division].

[113] *See Nedlloyd Lijnen B.V. Rotterdam v. Glow Laks Enterprises, Ltd.*, 747 Phil. 170 (2014) [Per J. Perez, First Division] and *International Harvester Co. in Russia v. Hamburg-American Line*, 42 Phil. 845 (1918) [Per J. Street, Second Division].

[114] *See Collector of Internal Revenue v. Fisher*, 110 Phil. 686 (1961) [Per J. Barrera, En Banc] and *Beam v. Yatco*, 82 Phil. 30 (1948) [Per J. Perfecto, Second Division].

[115] *See Wildvalley Shipping Co., Ltd. v. Court of Appeals*, 396 Phil. 383 (2000) [Per J. Buena, Second Division].

in this case.

It is a fundamental taxation principle that a state may tax persons, property, *income*, or business within its territorial limits.[117] Royalty income derived by a non-resident foreign corporation in the Philippines are generally taxed at 35% (for payments before January 1, 2009) pursuant to Section 28(B)(1)[118] of the National Internal Revenue Code of 1997. However, such royalties may be exempt or partially exempt (if subject to a reduced rate only) to the extent required by any treaty obligation binding on the Philippines. Section 32(B)(5) of the National Internal Revenue Code of 1997, as amended, provides:

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

Thus, a foreign corporation may avail of the benefits of a tax treaty concluded by the Philippines with its country of residence by invoking the treaty provisions and proving that they apply to it. In other words, unless clearly proven that the treaty provisions apply to it, a non-resident foreign corporation, like CAN Technologies, shall be taxed according to the National Internal Revenue Code of 1997, as amended.

Petitioner's claim on behalf of CAN Technologies for refund of "erroneously paid withholding tax on royalty income" is anchored on the

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116 *See ATCI Overseas Corporation v. Echin,* 647 Phil. 43 (2010) [Per J. Carpio Morales, Third Division] and *EDI-Staffbuilders International, Inc. v. National Labor Relations Commission,* 563 Phil. 1 (2007) [Per J. Velasco, Jr., Second Division].

117 *Manila Gas Corp. v. Collector of Internal Revenue,* 62 Phil. 895, 900 (1936) [Per J. Malcolm, En Banc].

118 TAX CODE, sec. 28 provides:
Section 28. *Rates of Income Tax on Foreign Corporations.* —
. . . .
(B) *Tax on Nonresident Foreign Corporation.* —
(1) *In General.* — Except as otherwise provided in this Code, a foreign corporation not engaged in trade or business in the Philippines shall pay a tax equal to thirty-five percent (35%) of the gross income received during each taxable year from all sources within the Philippines, such as interests, dividends, rents, royalties, salaries, premiums (except reinsurance premiums), annuities, emoluments or other fixed or determinable annual, periodic or casual gains, profits and income, and capital gains, except capital gains subject to tax under subparagraph 5 (c): Provided, That effective January 1, 2009, the rate of income tax shall be thirty percent (30%).

. . . .

10% preferential tax rate under the RP-Czech Tax Treaty, in relation to the most favored nation clause of the RP-US Tax Treaty. Consequently, compliance with the conditions for the applicability of the most favored nation clause must be proven as a fact. It is necessary to show the similarity in tax reliefs accorded by the United States and the Czech Republic under their respective treaties with the Philippines.

With regard to the RP-US Tax Treaty, a specific reference was made to the United States law for the limitation on allowable tax credit. This requires that the pertinent provisions of the United States law be presented in evidence. Whether the United States law imposes the same restrictions on tax credit as those imposed in the RP-Czech Tax Treaty is a question of fact that petitioner must prove.

Petitioner misapplies the doctrine of *processual presumption* in a bid to escape the consequences of its failure to present the pertinent provisions of the United States law.

A tax refund hinged on a lower tax rate under the RP-Czech Tax Treaty, in relation to the RP-US Tax Treaty, is akin to a tax exemption, and is strictly construed against the taxpayer.[119] Petitioner bears the burden of proving its claim indubitably. It cannot be permitted to rest on vague implications.[120] As this Court held:

> This Court has laid down the rule that "as the power of taxation is a high prerogative of sovereignty, the relinquishment is never presumed and any reduction or diminution thereof with respect to its mode or its rate, must be strictly construed, and the same must be coached in clear and unmistakable terms in order that it may be applied." More specifically stated, the general rule is that any claim for exemption from the tax statute should be strictly construed against the taxpayer.[121]

All told, the most favored nation clause cannot apply. Petitioner cannot avail of the lower 10% tax rate under the RP-Czech Tax Treaty for its failure to prove that the tax on royalties under the RP-US Tax Treaty was paid under circumstances similar to the tax on royalties under the RP-Czech Tax Treaty. Accordingly, there is no overpayment of tax on royalties from June 1, 2005 to April 30, 2007. The Court of Tax Appeals correctly denied petitioner's claim for refund of ₱8,771,270.71.

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119 *See Commissioner of Internal Revenue v. Mitsubishi Metal Corp.*, 260 Phil. 224 (1990) [Per J. Regalado, Second Division] and *PLDT v. City of Davao,* 415 Phil. 764 (2001) [Per J. Mendoza, Second Division].

120 *See Davao Light & Power Co., Inc. v. Commissioner of Customs,* 150 Phil. 940 (1972) [Per J. J.B.L. Reyes, First Division]; *Asiatic Petroleum Co., Ltd. v. Llanes,* 49 Phil. 466 (1926) [Per J. Street, En Banc].

121 *Luzon Stevedoring Corp. v. Court of Tax Appeals,* 246 Phil. 666, 671 (1988) [Per J. Paras, Second Division].

WHEREFORE, the Petition for Review on Certiorari is **DENIED**. The assailed May 24, 2012 Decision and August 30, 2012 Resolution of the Court of Tax Appeals *En Banc* in CTA EB No. 734 are **AFFIRMED**.

SO ORDERED.

MARVIC M.V.F. LEONEN
Associate Justice

WE CONCUR:

ALEXANDER G. GESMUNDO
Associate Justice

ROSMARI D. CARANDANG
Associate Justice

RODIL V. ZALAMEDA
Associate Justice

SAMUEL H. GAERLAN
Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution and the Division Chairperson's Attestation, I certify that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

DIOSDADO M. PERALTA
Chief Justice