THIRD DIVISION

[G.R. No. 127105, June 25, 1999]

COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS. S.C. JOHNSON AND SON, INC., AND COURT OF APPEALS, RESPONDENTS.

D E C I S I O N

GONZAGA-REYES, J.:

This is a petition for review on *certiorari* under Rule 45 of the Rules of Court seeking to set aside the decision of the Court of Appeals dated November 7, 1996 in CA-GR SP No. 40802 affirming the decision of the Court of Tax Appeals in CTA Case No. 5136.

The antecedent facts as found by the Court of Tax Appeals are not disputed, to wit:

> "[Respondent], a domestic corporation organized and operating under the Philippine laws, entered into a license agreement with SC Johnson and Son, United States of America (USA), a non-resident foreign corporation based in the U.S.A. pursuant to which the [respondent] was granted the right to use the trademark, patents and technology owned by the latter including the right to manufacture, package and distribute the products covered by the Agreement and secure assistance in management, marketing and production from SC Johnson and Son, U. S. A.
>
> The said License Agreement was duly registered with the Technology Transfer Board of the Bureau of Patents, Trade Marks and Technology Transfer under Certificate of Registration No. 8064 (Exh. "A").
>
> For the use of the trademark or technology, [respondent] was obliged to pay SC Johnson and Son, USA royalties based on a percentage of net sales and subjected the same to 25% withholding tax on royalty payments which [respondent] paid for the period covering July 1992 to May 1993 in the total amount of P1,603,443.00 (Exhs. "B" to "L" and submarkings).
>
> On October 29, 1993, [respondent] filed with the International Tax Affairs Division (ITAD) of the BIR a claim for refund of overpaid withholding tax on royalties arguing that, `the antecedent facts attending [respondent's] case fall squarely within the same circumstances under which said MacGeorge and Gillete rulings were issued. Since the agreement was approved by the Technology Transfer Board, the preferential tax rate of 10% should apply to the [respondent]. We therefore submit that royalties paid by the [respondent] to SC Johnson and Son, USA is only subject to 10% withholding tax

pursuant to the most-favored nation clause of the RP-US Tax Treaty [Article 13 Paragraph 2 (b) (iii)] in relation to the RP-West Germany Tax Treaty [Article 12 (2) (b)]' (Petition for Review [filed with the Court of Appeals], par. 12). [Respondent's] claim for the refund of P963,266.00 was computed as follows:

Month/ Year	Gross Royalty Fee	25% Withholding Tax Paid	10% Withholding Tax	Balance
July 1992	559,878	139,970	55,988	83,982
August	567,935	141,984	56,794	85,190
September	595,956	148,989	59,596	89,393
October	634,405	158,601	63,441	95,161
November	620,885	155,221	62,089	93,133
December	383,276	95,819	36,328	57,491
Jan 1993	602,451	170,630	68,245	102,368
February	565,845	141,461	56,585	84,877
March	547,253	136,813	54,725	82,088
April	660,810	165,203	66,081	99,122
May	603,076	150,769	60,308	90,461
	P6,421,770	P1,605,443	P642,177	P963,266"[1]
	========	========	=======	=======

The Commissioner did not act on said claim for refund. Private respondent S.C. Johnson & Son, Inc. (S.C. Johnson) then filed a petition for review before the Court of Tax Appeals (CTA) where the case was docketed as CTA Case No. 5136, to claim a refund of the overpaid withholding tax on royalty payments from July 1992 to May 1993.

On May 7, 1996, the Court of Tax Appeals rendered its decision in favor of S.C. Johnson and ordered the Commissioner of Internal Revenue to issue a tax credit certificate in the amount of P963,266.00 representing overpaid withholding tax on royalty payments beginning July, 1992 to May, 1993.[2]

The Commissioner of Internal Revenue thus filed a petition for review with the Court of Appeals which rendered the decision subject of this appeal on November 7, 1996 finding no merit in the petition and affirming *in toto* the CTA ruling.[3]

This petition for review was filed by the Commissioner of Internal Revenue raising the following issue:

> THE COURT OF APPEALS ERRED IN RULING THAT SC JOHNSON AND SON, USA IS ENTITLED TO THE "MOST FAVORED NATION" TAX RATE OF 10% ON ROYALTIES AS PROVIDED IN THE RP-US TAX TREATY IN RELATION TO THE RP-WEST GERMANY TAX TREATY.

Petitioner contends that under Article 13(2) (b) (iii) of the RP-US Tax Treaty, which is known as the "most favored nation" clause, the lowest rate of the Philippine tax at 10% may be imposed on royalties derived by a resident of the United States from sources within the Philippines only if the circumstances of the resident of the United States are similar to those of the resident of West Germany. Since the RP-US Tax Treaty contains no "matching credit" provision as that provided under Article 24 of the RP-West Germany Tax Treaty, the tax on royalties under the RP-US Tax Treaty is not paid under similar circumstances as those obtaining in the RP-West Germany Tax Treaty. Even assuming that the phrase "paid under similar circumstances" refers to the payment of royalties, and not taxes, as held by the Court of Appeals, still, the "most favored nation" clause cannot be invoked for the reason that when a tax treaty contemplates circumstances attendant to the payment of a tax, or royalty remittances for that matter, these must necessarily refer to circumstances that are tax-related. Finally, petitioner argues that since S.C. Johnson's invocation of the "most favored nation" clause is in the nature of a claim for exemption from the application of the regular tax rate of 25% for royalties, the provisions of the treaty must be construed strictly against it.

In its Comment, private respondent S.C. Johnson avers that the instant petition should be denied (1) because it contains a defective certification against forum shopping as required under SC Circular No. 28-91, that is, the certification was not executed by the petitioner herself but by her counsel; and (2) that the "most favored nation" clause under the RP-US Tax Treaty refers to royalties paid under similar circumstances as those royalties subject to tax in other treaties; that the phrase "paid under similar circumstances" does not refer to payment of the tax but to the subject matter of the tax, that is, royalties, because the "most favored nation" clause is intended to allow the taxpayer in one state to avail of more liberal provisions contained in another tax treaty wherein the country of residence of such taxpayer is also a party thereto, subject to the basic condition that the subject matter of taxation in that other tax treaty is the same as that in the original tax treaty under which the taxpayer is liable; thus, the RP-US Tax Treaty speaks of "royalties of the same kind paid under similar circumstances". S.C. Johnson also contends that the Commissioner is estopped from insisting on her interpretation that the phrase "paid under similar circumstances" refers to the manner in which the tax is paid, for the reason that said interpretation is embodied in Revenue Memorandum Circular ("RMC") 39-92 which was already abandoned by the Commissioner's predecessor in 1993; and was expressly revoked in BIR Ruling No. 052-95 which stated that royalties paid to an American licensor are subject only to 10% withholding tax pursuant to Art 13(2)(b)(iii) of the RP-US Tax Treaty in relation to the RP-West Germany Tax Treaty. Said ruling should be given retroactive effect except if such is prejudicial to the taxpayer pursuant to Section 246 of the National Internal Revenue Code.

Petitioner filed Reply alleging that the fact that the certification against forum shopping was signed by petitioner's counsel is not a fatal defect as to warrant the dismissal of this petition since Circular No. 28-91 applies only to original actions and not to appeals, as in the instant case. Moreover, the requirement that the certification should be signed by petitioner and not by counsel does not apply to petitioner who has only the Office of the Solicitor General as statutory counsel. Petitioner reiterates that even if the phrase "paid under similar circumstances" embodied in the most favored nation clause of the RP-US Tax Treaty refers to the payment of royalties and not taxes, still the presence or absence of a "matching credit" provision in the said RP-US Tax Treaty would constitute a material circumstance to such payment and would be determinative of the said clause's application.

We address first the objection raised by private respondent that the certification against forum shopping was not executed by the petitioner herself but by her counsel, the Office of the Solicitor General (O.S.G.) through one of its Solicitors, Atty. Tomas M. Navarro.

SC Circular No. 28-91 provides:

> "SUBJECT: ADDITIONAL REQUISITES FOR PETITIONS FILED WITH THE SUPREME COURT AND THE COURT OF APPEALS TO PREVENT FORUM SHOPPING OR MULTIPLE FILING OF PETITIONS AND COMPLAINTS
>
> TO : xxx xxx xxx
>
> The attention of the Court has been called to the filing of multiple petitions and complaints involving the same issues in the Supreme Court, the Court of Appeals or other tribunals or agencies, with the result that said courts, tribunals or agencies have to resolve the same issues.
>
> (1) To avoid the foregoing, in every petition filed with the Supreme Court or the Court of Appeals, the petitioner aside from complying with pertinent provisions of the Rules of Court and existing circulars, must certify under oath to all of the following facts or undertakings: (a) he has not theretofore commenced any other action or proceeding involving the same issues in the Supreme Court, the Court of Appeals, or any tribunal or agency; xxx
>
> (2) Any violation of this revised Circular will entail the following sanctions: (a) it shall be a cause for the summary dismissal of the multiple petitions or complaints; xxx"

The circular expressly requires that a certificate of non-forum shopping should be attached to petitions filed before this Court and the Court of Appeals. Petitioner's allegation that Circular No. 28-91 applies only to original actions and not to appeals as in the instant case is not supported by the text nor by the obvious intent of the Circular which is to prevent multiple petitions that will result in the same issue being resolved by different courts.

Anent the requirement that the party, not counsel, must certify under oath that he has not commenced any other action involving the same issues in this Court or the Court of Appeals or any other tribunal or agency, we are inclined to accept petitioner's submission that since the OSG is the only lawyer for the petitioner, which is a government agency mandated under Section 35, Chapter 12, title III, Book IV of the 1987 Administrative Code[4] to be represented only by the Solicitor General, the certification executed by the OSG in this case constitutes substantial compliance with Circular No. 28-91.

With respect to the merits of this petition, the main point of contention in this appeal is the interpretation of Article 13 (2) (b) (iii) of the RP-US Tax Treaty regarding the rate of tax to be imposed by the Philippines upon royalties received by a non-resident foreign corporation. The provision states insofar as pertinent that-

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

Respondent S. C. Johnson and Son, Inc. claims that on the basis of the quoted provision, it is entitled to the concessional tax rate of 10 percent on royalties based on Article 12 (2) (b) of the RP-Germany Tax Treaty which provides:

> (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 the tax so charged shall not exceed:
>
> x x x
>
> b) 10 percent 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 Philippine competent authorities.

Unlike the RP-US Tax Treaty, the RP-Germany Tax Treaty allows a tax credit of 20 percent of the gross amount of such royalties against German income and corporation tax for the taxes payable in the Philippines on such royalties where the tax rate is reduced to 10 or 15 percent under such treaty. Article 24 of the RP-Germany Tax Treaty states-

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

x x x x x x x x x

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

x x x x x x x x x

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

x x x x x x x x x

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

x x x x x x x x x

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

x x x x x x x x x

According to petitioner, the taxes upon royalties under the RP-US Tax Treaty are not paid under circumstances similar to those in the RP-West Germany Tax Treaty since there is no provision for a 20 percent matching credit in the former convention and private respondent cannot invoke the concessional tax rate on the strength of the most favored nation clause in the RP-US Tax Treaty. Petitioner's position is explained thus:

"Under the foregoing provision of the RP-West Germany Tax Treaty, the Philippine tax paid on income from sources within the Philippines is allowed as a credit against German income and corporation tax on the same income. In the case of royalties for which the tax is reduced to 10 or 15 percent according to paragraph 2 of Article 12 of the RP-West Germany Tax Treaty, the credit shall be 20% of the gross amount of such royalty. To illustrate, the royalty income of a German resident from sources within the Philippines arising from the use of, or the right to use, any patent, trade mark, design or model, plan, secret formula or process, is taxed at 10% of the gross amount of said royalty under certain conditions. The rate of 10% is imposed if credit against the German income and corporation tax on said royalty is allowed in favor of the German resident. That means the rate of 10% is granted to the German taxpayer if he is similarly granted a credit against the income and corporation tax of West Germany. The clear intent of the `matching credit' is to soften the impact of double taxation by different jurisdictions.

> The RP-US Tax Treaty contains no similar `matching credit' as that provided under the RP-West Germany Tax Treaty. Hence, the tax on royalties under the RP-US Tax Treaty is not paid under similar circumstances as those obtaining in the RP-West Germany Tax Treaty. Therefore, the `most favored nation' clause in the RP-West Germany Tax Treaty cannot be availed of in interpreting the provisions of the RP-US Tax Treaty."[5]

The petition is meritorious.

We are unable to sustain the position of the Court of Tax Appeals, which was upheld by the Court of Appeals, that the phrase "paid under similar circumstances in Article 13 (2) (b), (iii) of the RP-US Tax Treaty should be interpreted to refer to payment of royalty, and not to the payment of the tax, for the reason that the phrase "paid under similar circumstances" is followed by the phrase "to a resident of a third state". The respondent court held that "Words are to be understood in the context in which they are used", and since what is paid to a resident of a third state is not a tax but a royalty "logic instructs" that the treaty provision in question should refer to royalties of the same kind paid under similar circumstances.

The above construction is based principally on syntax or sentence structure but fails to take into account the purpose animating the treaty provisions in point. To begin with, we are not aware of any law or rule pertinent to the payment of royalties, and none has been brought to our attention, which provides for the payment of royalties under dissimilar circumstances. The tax rates on royalties and the circumstances of payment thereof are the same for all the recipients of such royalties and there is no disparity based on nationality in the circumstances of such payment.[6] On the other hand, a cursory reading of the various tax treaties will show that there is no similarity in the provisions on relief from or avoidance of double taxation[7] as this is a matter of negotiation between the contracting parties.[8] As will be shown later, this dissimilarity is true particularly in the treaties between the Philippines and the United States and between the Philippines and West Germany.

The RP-US Tax Treaty is just one of a number of bilateral treaties which the Philippines has entered into for the avoidance of double taxation.[9] 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.[10] 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.[11], citing the Committee on Fiscal Affairs of the Organization for Economic Co-operation and Development (OECD).11 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.[12] 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.[13]

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.[14]

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, whereas the credit method focuses upon the tax.[15]

In 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.[16] Thus the petitioner correctly opined that the phrase "royalties paid under similar circumstances" in the most favored nation clause of the US-RP Tax Treaty necessarily contemplated "circumstances that are tax-related".

In the case at bar, the state of source is the Philippines because the royalties are paid for the right to use property or rights, i.e. trademarks, patents and technology, located within the Philippines.[17] The United States is the state of residence since the taxpayer, S. C. Johnson and Son, U. S. A., is based there. Under the RP-US Tax Treaty, the state of residence and the state of source are both permitted to tax the royalties, with a restraint on the tax that may be collected by the state of source.[18] Furthermore, the method employed to give relief from double taxation is the allowance of a tax credit to citizens or residents of the United States (in an appropriate amount based upon the taxes paid or accrued to the Philippines) against the United States tax, but such amount shall not exceed the limitations provided by United States law for the taxable year.[19] Under Article 13 thereof, the Philippines may impose one of three rates- 25 percent of the gross amount of the royalties; 15 percent when the royalties are paid by a corporation registered with the Philippine Board of Investments 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 a third state.

Given the purpose underlying tax treaties and the rationale for the most favored nation clause, the concessional tax rate of 10 percent provided for in the RP-Germany Tax Treaty should apply only if the taxes imposed upon royalties in the RP-US Tax Treaty and in the RP-Germany Tax Treaty are paid under similar circumstances. This would mean that private respondent must prove that the RP-US Tax Treaty grants similar tax reliefs to residents of the United States in respect of the taxes imposable upon royalties earned from sources within the Philippines as those allowed to their German counterparts under the RP-Germany Tax Treaty.

The RP-US and the RP-West Germany Tax Treaties do not contain similar provisions on tax crediting. Article 24 of the RP-Germany Tax Treaty, *supra*, expressly allows crediting against German income and corporation tax of 20% of the gross amount of royalties paid under the law of the Philippines. On the other hand, Article 23 of the RP-US Tax Treaty, which is the counterpart provision with respect to relief for double taxation, does not provide for similar crediting of 20% of the gross amount of royalties paid. Said Article 23 reads:

"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 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. xxx".

The reason for construing the phrase "paid under similar circumstances" as used in Article 13 (2) (b) (iii) of the RP-US Tax Treaty as referring to taxes is anchored upon a logical reading of the text in the light of the fundamental purpose of such treaty which is to grant an incentive to the foreign investor by lowering the tax and at the same time crediting against the domestic tax abroad a figure higher than what was collected in the Philippines.

In one case, the Supreme Court pointed out that laws are not just mere compositions, but have ends to be achieved and that the general purpose is a more important aid to the meaning of a law than any rule which grammar may lay down.[20] It is the duty of the courts to look to the object to be accomplished, the evils to be remedied, or the purpose to be subserved, and should give the law a reasonable or liberal construction which will best effectuate its purpose.[21] The Vienna Convention on the Law of Treaties states that a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.[22]

As stated earlier, the ultimate reason for avoiding double taxation is to encourage foreign investors to invest in the Philippines - a crucial economic goal for developing countries.[23] 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.[24] 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.

At the same time, the intention behind the adoption of the provision on "relief from double taxation" in the two tax treaties in question should be considered in light of the purpose behind the most favored nation clause.

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.[25] 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.[26] 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.

We accordingly agree with petitioner that since the RP-US Tax Treaty does not give a matching tax credit of 20 percent for the taxes paid to the Philippines on royalties as allowed under the RP-West Germany Tax Treaty, private respondent cannot be deemed entitled to the 10 percent rate granted under the latter treaty for the reason that there is no payment of taxes on royalties under similar circumstances.

It bears stress that tax refunds are in the nature of tax exemptions. As such they are regarded as in derogation of sovereign authority and to be construed *strictissimi juris* against the person or entity claiming the exemption.[27] The burden of proof is upon him who claims the exemption in his favor and he must be able to justify his claim by the clearest grant of organic or statute law.[28] Private respondent is claiming for a refund of the alleged overpayment of tax on royalties; however, there is nothing on record to support a claim that the tax on royalties under the RP-US Tax Treaty is paid under similar circumstances as the tax on royalties under the RP-West Germany Tax Treaty.

WHEREFORE, for all the foregoing, the instant petition is **GRANTED.** The decision dated May 7, 1996 of the Court of Tax Appeals and the decision dated November 7, 1996 of the Court of Appeals are hereby **SET ASIDE.**

SO ORDERED.

Vitug, Panganiban, and *Purisima JJ.,* concur.
Romero (Chairman), J., abroad, on official business leave.

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[1] Petition, pp. 3-5; *Rollo*, pp. 10-12.1

[2] *Rollo*, p. 67.2

[3] Penned by Justice Hilarion L. Aquino, concurred in by Justices Jainal D. Rasul, Chairman, and Hector L. Hofileña.3

[4] Reiterated under Memorandum Circular No. 152 dated May 17, 1992.4

[5] Petition, pp. 10-11; *Rollo*, pp. 17-18.5

[6] See E. A. E. Ortuoste, Tax Treaty Rates: A Summary, Phil. Revenue Journal, vol. 34, No.2 March-April 1997.6

[7] Article 24 RP-Australia, Article 23 RP-Belgium, Article 23 RP-Brazil, Article 22 RP-Canada, Article 23 RP-Denmark, Article 22, RP-Finland, Article 23 RP-France, Article 24, RP-Germany, Article 24, RP-India, Section 31 RP-Indonesia, Article 22 RP-Italy, Article 23 RP-Japan, Article 23 RP-South Korea, Article 22 RP-Malaysia, Article 22 RP Netherland, Article 23 RP-New Zealand, Article 23 RP-Pakistan, Section 29 RP-Singapore, Article 23 RP-Spain, Article 18 RP-Sweden, Article 23 RP-Thailand, Article 21 RP-United Kingdom, Article 23 RP-US.7

[8] See Toledo, International Aspects of Taxation, Proceedings of the Eleventh Annual Institute on Tax Law (1976) @ p. 19.8

[9] As of June 29, 1997, the following countries have entered into tax treaties with the Philippines for

the avoidance of double taxation: Denmark, Singapore, Canada, France, United Kingdom, Pakistan, Australia, Japan, Belgium, New Zealand, Finland, Indonesia, Austria, United States of America, Thailand, Germany, Malaysia, Korea, Sweden, Italy, Netherlands, Brazil, Spain, India, and Israel.9

[10] P. Baker, Double Taxation Conventions and International Tax Law (1994), 6.10

[11] *Ibid*, 11

[12] *Ibid*.12

[13] *Ibid*.13

[14] *Ibid*, 70.14

[15] *Ibid*, 70-72.15

[16] T. Toledo, *Ibid*, @ p. 18-19.

> "Take the case of a hundred pesos dividend to be remitted to, let us say a stockholder of United States of America. The hundred peso dividend, if you apply the withholding tax assuming that there is no sparing credit, we taxed 35%. So, out of P100.00, you are taxed P35.00. The Philippines under this law is willing to tax him only at P15.00 so his net dividends is P85.00. If the United States will tax the full P85.00, there is no reason why we should reduce our tax. If we collected from him P35.00 tax out of the P100.00 dividend, then his net dividend is only P65.00. So, instead of transferring the collections from the Philippines Treasury to the U.S. Treasury, we might just as well retainer tax because we need these revenues.
>
> This is always true when it comes to a developing country such as ours entering into a treaty with developed country like U. S, what do we do in tax treaties? One or two things. First, we give consideration to investments especially where the investor controls either 10% of the voting shares of the company in the Philippines or 25% of its capital. When the investment exceeds this proportion I've just mentioned, we reduce the rate of tax from 15 to 10% on condition that on the tax credit provision in the same treaty we asked the developed country to credit this investor with the tax actually at a higher rate and was paid in the Philippines. In other words, there would be some incentives on the part of the foreigners to invest in the Philippines because the rates of tax are lowered and at the same time they are credited against the domestic tax abroad a figure higher than what was collected in the Philippines. xxx"16

[17] Under Article 4 (3) of the RP-US Tax Treaty, royalties for the use of, or the right to use, property or rights shall be treated as income from sources within a Contracting State only to the extent that such royalties are for the use of, or the right use, such property or rights within that Contracting State.17

[18] RP-US Tax Treaty, Article 13.18

[19]19 *Id*, Article 23.19

[20] Litex Employees Association *vs.* Eduvala, 79 SCRA 88, September 22, 1977.20

[21] Paras, *vs.* Commission on Elections, G. R. No. 123169, November 4, 1996; San Miguel Corporation Employees Union-PTGWO *vs.* Confesor, G. R. No. 111262, September 19, 1996; Agujitas *vs.* Court of Appeals, G. R. No. 106560, August 23, 1996; Sajonas *vs.* Court of Appeals, G. R. No. 102377, July 5, 1996; Escribano *vs.* Avila, 85 SCRA 245, September 12, 1978; Homes Ins. Co. *vs.* Eastern Shipping Lines, 123 SCRA 424, July 20, 1983.21

[22] Vienna Convention on the Law of Treaties, Article 31.22

[23] Toledo, s*upra,* at p. 17.23

[24] *Ibid*, 19.24

[25] Salonga, Yap, Public International Law, 255.25

[26] Black's Law Dictionary 5th ed., 913.26

[27] Commissioner of Internal Revenue *vs.* Tokyo Shipping Co., Ltd., 244 SCRA 332; Province of Tarlac *vs.* Alcantara, 216 SCRA 790; Magsaysay Lines, Inc. *vs.* Court of Appeals, 260 SCRA 513.27

[28] Wonder Mechanical Engineering Corporation *vs.* CTA, 64 SCRA 555.28
