THIRD DIVISION

[G.R. No. 203346, September 09, 2020]

CARGILL PHILIPPINES, INC., PETITIONER, VS. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

D E C I S I O N

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 denied Cargill Philippines, Inc.'s (Cargill) claim for refund or tax credit worth P8,771,270.71, 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 P175,425,414.12 as royalties, less withholding final taxes at the rate of 15%, or P26,313,812.10.[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]

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, m 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 P8,771,270.71, 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]

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 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 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 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 P8,771,270.71, 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 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, 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 P8,771,270.71, representing erroneously paid final withholding taxes on royalties paid to CAN Technologies from June 1, 2005 to April 30, 2007.