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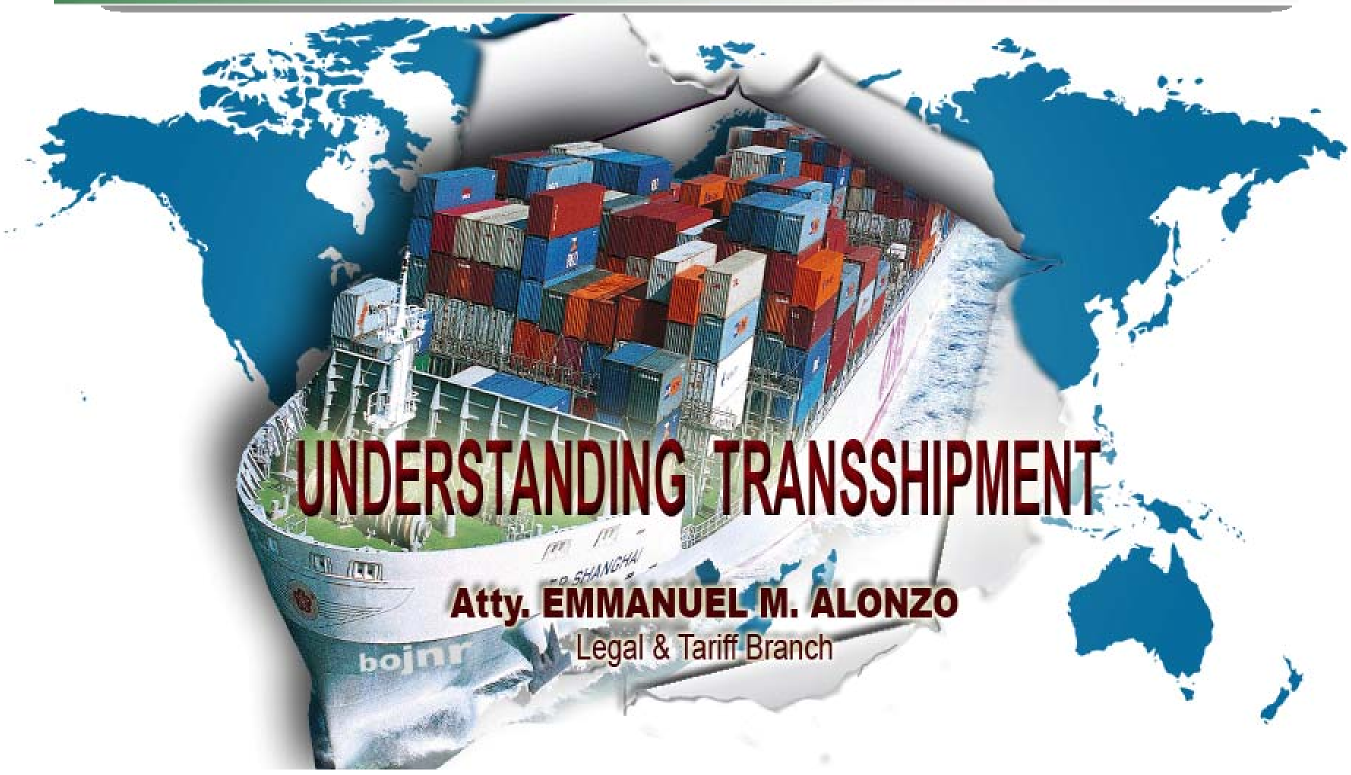

Definition of transshipment

Transshipment[1] is defined as the transfer of a shipment from one carrier or vessel to another while in transit. Transshipments are usually made:

1. when there is no direct air, land, or sea link between consignor's and consignee's countries,
2. where the intended port of entry is blocked, or
3. when the importer wants to hide the identity of the port or country of origin.

In the Philippines, there are two kinds of transshipments, foreign and domestic. Their common characteristics are that taxes and duties are not paid while in transit, and obviously, there is a "*transshipment"* or movement of the goods from one place to another.

Transshipment, whether foreign or domestic, is prone to smuggling.

During the domestic transshipment, the product transported are under bond, or any kind of guaranty, and under the supervision of the Bureau of Customs (BOC).

Foreign transshipment

Foreign transshipment occurs when imports enter the domestic ports, but such imports do not enter the domestic market.

It is a new concept in the Philippines, brought about by the creation of the free trade agreements like the ASEAN, and on a larger scale, the globalization of international trade.

Advantages and disadvantages of foreign transshipment

In a study[2], foreign transshipment promotes containerization, which may be translated into savings for the exporter. It reduces container traffic and saves time, an important factor for both the port and the concerned private sector. It also reduces dependence on foreign port services, and increases the volume of import in the form of containers.

For the government, foreign transshipment increases foreign exchange, increases employment opportunities, develops port-based activities, and makes the export-import trade more competitive in the

1 http://www.businessdictionary.com/definition/transshipment.html.
2 http://www.scribd.com/doc/54412221/Economic-Advantages-of-International-Container-Transshipment-Terminal.

international market, resulting in the industrial growth in the region.

With all its advantages, the down-side of foreign transshipment is that it increases smuggling.

In some cases, foreign transshipment is discouraged because it exposes the shipment to a higher probability of damage or loss. Some purchase orders or letters of credit specifically prohibit it.

“Sin” taxes

Of special interest are the transshipments of cigarettes and alcohol products. According to Philip Morris, Inc. the major transshipment points are the ports of Manila (MICP and South Harbor); Subic Bay Freeport Zone, Olongapo City; Currimao and Salomague in the Ilocos Province. Transshipment of cigarettes involves tax-and duty free suspended cigarettes from foreign ports, which are brought to various Philippine ports, for subsequent transport to foreign ports. For example, the transshipment routes are: (a) Singapore-Subic-Vietnam; (b) Hong Kong-Manila-Subic-Taiwan; and (c) Hongkong-Manila-Currimao/Salomague-Vietnam.[3]

In the foreign transshipment of cigarettes, the products are supposed to remain in the vessel because they are not intended for the domestic market. Somehow, imported cigarettes may be substituted with locally manufactured ones since imported cigarettes command higher selling price than locally manufactured cigarettes. After the substitution, the local cigarettes are the ones transshipped (discharged to the destined foreign port). In other words, smuggling has occurred.

The Revised Kyoto Convention (RKC)

The first Kyoto Convention emerged in 1974 in order to simplify and harmonize customs procedures. From 1974 onwards, many developments arose, primarily the creation of the World Trade Organization in 1995 which covers the substantial aspect of international trade. The need therefore arose for an updated procedure on international trade, hence the Revised Kyoto Convention (RKC) came into force on February 3, 2006.

Simplifying trade is easier said than done. Firstly, the different trading countries have different levels of development. It means that more developed countries tend to fully liberalize trade because their economies do not rely much on revenues from customs duties. In a developing country like the Philippines, government revenues as a consequence of importations account for a substantial portion of the total government income. Furthermore, in practice, a treaty, like the RKC, covering only the procedural aspect of trading, also affects the substantial aspects of importation. There seems to be a thin line between treaties affecting procedural aspect and those affecting the substantive aspect. For example, an attempt to liberalize the entry of imports would also mean an increase in smuggling activities, which in turn will adversely affect the cherished government revenues, as in the case of the Philippines.

This apprehension by the Philippines led to a late ratification by the Philippine Senate on February 1, 2010 (roughly after 3 years since the existence of the RKC).

The framers of the RKC recognize the dilemma by allowing countries to accept some provisions, and at the same time, reject those provisions detrimental to their respective economies. For example, the Philippines adheres to the idea that some portions of its territory are outside its tax jurisdiction. It means that ports situated inside the freeports are treated separately from ordinary ports. This difference in treatment is contrary to the RKC. Under the RKC, all ports of its member-countries are treated the same.

For a specific example related to transshipment, the RKC Specific Annex C Chapter 1 provides that Customs shall not require evidence of the arrival of the goods abroad as a matter of course.

According to the International Container Terminal Services, Inc. (ICTSI), the requirement and the consequence for non-compliance thereof are unheard of in other countries. The requirement of securing a certificate of discharge from a foreign jurisdiction is a tacit admission that the existing procedures of the Bureau of Customs to prevent smuggling do not work.

A case in point

A total of 2,219 containers were transshipped from the Port of Manila (POM) and the Manila International Container Port (MICP) from January to May 2011. POM transshipped 1,626 containers while the MICP transshipped 593 to the Port of Batangas (POB). Somehow, only 309 containers were actually received by the Batangas Port, while the rest of the containers, 1,910 of them, remained missing.

The smuggling was accomplished due to the following reasons[4]:

1. The boat notes submitted by the Pier Inspection Division (PID) personnel at the POM and the MICP were forgeries;

2. There were attempts to cover up misdeeds by making it appear that the returned transshipment permits covering the missing shipments were duly received at the port of destination (POB);

3. The wharfinger personnel at the POM and the MICP assigned only a handful of customs guards to attend to 2,219 containers despite the availability of customs guards, paving the way to

3 Arce, Chita, Comments of Philip Morris, Inc.; April 17, 2006

4 Presented during the meeting of the COCCTRP (Congressional Oversight Committee on the Comprehensive Tax Reform Program) held at the Senate session hall on September 14, 2011.

familiarization and collusion between the assigned guards and the brokers/ importers resulting to the loss or non-delivery of the shipments;

4. There was failure to comply with CMO 43-2010 requiring the POB Deputy Collector for Operations to tag all received cargos and to send electronic mail to the Deputy Collector for Operations of the Port of Discharge communicating the arrival of the shipment at the port of destination;

5. The Deputy Collectors for Operations of the POM and the MICP failed to ensure that the shipments undergo the required x-ray examination and submission of its printout per CMO 14-2011. They continuously allowed the transshipment despite the lack of notice that the previous shipments have been received at the port of destination, pursuant to CMO 43-2010. They approved the application for transshipment even if the registered address of the importer is nearer to the port of discharge, despite such act being prohibited under CMO 9-2011;

6. The Piers Inspection Division Chiefs of the POM and the MICP allowed the continuous transshipment despite records in the computer that the transferred shipments have not been received at the port of destination, and for allowing the assignment of a handful of customs guards to undertake the under guarding, resulting to the loss or non-delivery of the shipment; and

7. The concerned private sector was allowed to claim the security fee for the missing containers and securing refund therefor. They also assisted in the processing and facilitation for the release of the subject transshipped cargos and conspiring with the BOC officials and other persons for the illegal release of the imports.

Domestic transshipment

Domestic transshipment occurs when imports are disembarked in a domestic port, transported via land, sea, or air, and finally delivered to a customs bonded warehouse (CBW), like those owned by the Philippine Economic Zone Authority (PEZA). The imports are usually *"raw materials"* used to produce a finished product destined for re-exportation. If the finished product enters the domestic market, which is allowed by law[5], taxes and duties must be paid for such finished product. The rest of the stock are then re-exported. In domestic transshipment, products enter the tax jurisdiction twice: first the transportation from the pier to the CBW, and second, when the finished product is transported from the CBW to the port for re-exportation.

The Tariff and Customs Code of the Philippines has the following provisions on transshipment:

PART 3. – TRANSPORTATION IN BOND

SEC. 2101. Entry for Immediate Transportation. – Articles entered for constructive warehousing and immediate transportation under transit manifest to other ports of the Philippines without appraisement may be transported ***under irrevocable domestic letter of credit, bank guarantee or bond, upon proper examination and consigned to the Collector at the port of destination****, who will allow entry to be made at his port by the consignee.*

Articles received at any port from another port of the Philippines on an entry for immediate transportation may be entered at the port of delivery ***either for consumption or warehousing.***

SEC. 2102. Bonding of Carrier Transporting Articles Under the Preceding Section. – A carrier engaged in conveying imported articles under the preceding section from a port of importation to other ports shall give a security in the nature of a ***general transportation bond,*** *in a sum not less than ten thousand pesos (P 10,000.00) conditioned that the carrier shall transport and deliver without delay, and in accordance with law and regulations, to the Collector at the port of destination all articles delivered to such carrier and that all proper charges and expenses incurred by the customs authorities or at their instance by reason of such transshipments shall be duly paid.*

SEC. 2103. Articles Entered for Immediate Exportation.- When an intent to export the articles is shown by the bill of lading, invoice, manifest, or other satisfactory evidence, the whole or a part of a bill (not less than one package) may be entered for immediate exportation under bond. The Collector shall designate the vessel or aircraft in which the articles are laden constructively as a warehouse to facilitate the direct transfer of the articles to the exporting vessel or aircraft.

Unless it shall appear by the bill of lading, invoice, manifest, or other satisfactory evidence, that articles arriving in the Philippines are destined for transshipment, no exportation thereof will be permitted except under entry for immediate exportation under irrevocable domestic letter of credit, bank guaranty or bond ***in an amount equal to the ascertained duties, taxes and other charges.***

Upon the exportation of the articles, and ***the production of proof of landing beyond the limits of the Philippines****, the irrevocable letter of credit, bank guaranty or bond shall be released.*

5 Please refer to the charter of PEZA.

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A. BACKGROUND

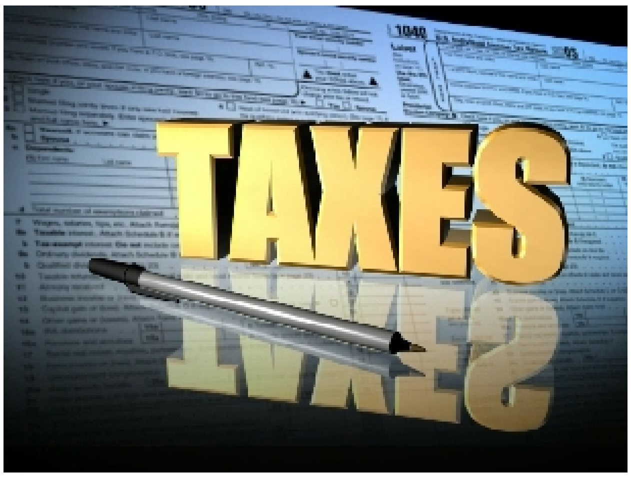
Many countries have forged with other countries to have an agreement or a treaty to mitigate the effects of double taxation. A treaty (commonly referred to as a convention) is an agreement between states, in which taxation provisions are set where incomes are linked to both states[1]. The Fiscal Committee of the OECD in the Model Double Taxation Convention on Income and Capital, 1977, defines "the phenomenon of international juridical double taxation" 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 period". Therefore, the basic cause of international multiple taxation is the exercise by sovereign states of their inherent right to levy tax extra-territorially. Most of the countries subject their residents to tax, on the basis of "personal jurisdiction, on their global income including income arising or having its source in foreign countries."

Tax Treaty may cover income taxes, inheritance taxes, value added taxes, or other taxes. The main goal of a tax treaty is to prevent a situation in which both states levy taxes on the same income (double taxation). Other goals include:

- improving coordination between states;
- collection of taxes and preventing tax avoidance and tax evasion;
- exchange of information;
- setting the basis of mutual agreement procedure;
- setting non-discrimination provisions;
- opening direct communication channels between the two tax administrations; and
- decreasing the vagueness, thereby increasing the certainty regarding the other state's domestic law for better mutual investment and trade.

In general, the benefits of tax treaties are available only to persons who are residents of one of the treaty countries. In most cases, a resident of a country is any person that is subject to tax under the domestic laws of that country by reason of domicile, residence, place of incorporation, or similar criteria. Tax treaties usually specify the same maximum rate of tax that may be imposed on some types of income. As an example, a treaty may provide that interest earned by a nonresident eligible for benefits under the treaty is taxed at no more than five percent (5%). However, local law in some cases may provide a lower rate of tax irrespective of the treaty. In such cases, the lower local law rate prevails.

1 Avoidance of double taxation treaties http://www.moit.gov.il/NRexeres



Is double taxation allowed?[2]

Double taxation, in general, is not forbidden by our fundamental law since we have not yet adopted as part hereof the injunction against double taxation found in the Constitution of the United States of America (USA). Double taxation becomes obnoxious only where the taxpayer is taxed twice for the benefit of the same government entity or by the same jurisdiction for the same purpose, but not in a case where one tax is imposed by the State and the other by the city or municipality.

In international law, double taxation usually takes place when a person is resident of a particular country and derives income from, or owns capital in another country and both states impose tax on that income or capital.

In order to eliminate double taxation in international law, a tax treaty may avail of several methods, namely:

- It may set 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 parties; 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. In negotiating tax treaties, the underlying rationale for reducing 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.

- 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. This may be through a tax treaty relief ruling from the International Affairs Division of the Bureau of Internal Revenue.

An Avoidance of Double Taxation was entered into by the Philippines with many countries to prevent double taxation of income earned in one country by a resident of the other country. Our Supreme Court has defined double taxation as taxing the same property twice when it should be taxed only once; or taxing the same person twice by the same jurisdiction for the same thing. Otherwise, described as "direct duplicate taxation", the two taxes must be imposed on the same subject matter, for the same purpose, by the same taxing authority, within the same jurisdiction, during the same taxing period. And they must be of the same kind or character.

Tax Treaty Model

There are two models in tax treaty crafting which were profounded by the United Nations and OECD, namely:

1. OECD Model – This model basically favors capital exporting counties by giving relief for double tax by reducing tax in source country. Business incomes are exempt unless foreign residents have permanent establishment in source state.

2. United Nations Model – published in 1980 which was basically based on OECD Model with modification to take into account special issues and concerns of developing countries. For instance, it allows easier permanent establishment for foreigners and leaves reduction in withholding rates to Bilateral Negotiations, and it also promotes tax sparing.

Tax treaty interpretation is governed by International Law, i.e., Vienna Convention on Law of Treaties, Art. 31 (1) viz, a treaty should be interpreted in good faith and in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose.

NTRC Study[3]

According to OECD, in today's globalized economy, "effective information exchange is essential for countries to maintain sovereignty over the application and enforcement of their tax laws and to ensure the correct application of tax conventions.[4] "However, such practice is not easily enforceable by tax authorities considering the need for them to respect national borders. The presence of provisions for the exchange of information will therefore provide tax authorities the required "legal framework for cooperating across borders without violating the sovereignty of other countries or the rights of taxpayers."[5]

The unprecedented liberalization and globalization of national economies in the past decades where an increasing number of countries have removed or limited controls on foreign investment and relaxed or eliminated

2 Is double taxation allowed? Inquirer.net, Philippine News for Fili…http://globalnation.inquirer.net/cebudailynews/enterprise/view/2010
3 National Tax Research Center is an attached Office under the Department of Finance. This comments was submitted to the
4 Source:http://www.oecd.org/about/. viewed on May 29, 2009.
5 Ibid.

foreign controls and where tax administration remains confined to their respective jurisdictions while taxpayers operate globally, deemed it necessary for the OECD to focus on improved transparency and cooperation between tax authorities. Cooperation in tax matters, specifically, helps to ensure that taxpayers who have access to cross-border transactions do not also have access to greater tax evasion and avoidance possibilities than taxpayers operating only in their domestic market. It likewise reflects the basic principle that participation in the global economy carries both benefits and responsibilities.[6]

The Internationally Agreed Tax Standards (IATS) was developed by the OECD and non-OECD countries in the context of the OECD's Global Forum on Taxation and endorsed by the G20 Finance Ministries in 2004 and by the UN Committee of Experts on International Cooperation in Tax Matters on October 2008[7]. This standard requires the exchange of information on request in all matters for the administration and enforcement of domestic law without regard to a domestic tax interest[8] requirement or bank secrecy for tax purposes. It likewise provides for extensive safeguards to protect the confidentiality of the information exchanged.

Exchange of information is a key element of international cooperation in tax matters. It is said to be an effective way for countries to maintain sovereignty over their own tax bases and to ensure the correct allocation of taxing rights between tax treaty partners. There is said to be two purposes for which information is exchanged. The first is to ascertain the facts in relation to which the rules of an income tax convention are to be applied; and the second, to assist one of the contracting parties in administering or enforcing its domestic tax law.

Article 26 of the OECD Model Convention on Income and Capital provides for the framework within which contracting parties can exchange information. The said article enumerates three main forms of information exchange[9], namely:

a. On Request – refers to a situation where the competent authority of one country asks for particular information from the competent authority of another contracting party.

b. Automatic – refers to information that is exchanged automatically and typically consists of details of income arising from sources in the source country, e.g., interest, dividends, royalties, pensions, etc. Information through this form is obtained on a routine basis (generally through reporting of the payments by the payer) by the sending country and is thus available for transmission to its treaty partners[10].

c. Spontaneous – refers to information exchange where one of the contracting parties, having obtained information in the course of administering its own tax laws which it believes will be of interest to one of its treaty partners for tax purposes, passes on the information without the latter having to ask for it.

Other forms of information exchange aside from the traditional forms mentioned above are the following:

a. Simultaneous tax examinations – an arrangement by two or more countries to examine simultaneously and independently, each on its territory, the tax affairs of (a) taxpayer(s) in which they have a common or related interest with a view of exchanging any relevant information which they so obtain.

b. Visit of authorized representatives of the component authorities – refers to a travel to a foreign jurisdiction for purposes of gathering information for a particular case. This visit, however, has to be authorized by the foreign jurisdiction (and be permitted by the laws of the sending country); otherwise it would represent a breach of sovereignty. The decisions, therefore, on whether or not to authorize such visits, and if so, whether the presence of foreign tax officials should require the consent of the taxpayer (as well as many other terms and conditions for such visits) shall fall within the sole discretion of individual countries.

c. Industry-wide exchange of information – does not concern a specific taxpayer but an economic sector as a whole, for instance, the pharmaceutical industry or the oil industry. This involves representatives of contracting parties meeting to discuss the way in which a particular economic sector operates, the financing schemes, the way prices are determined, the tax evasion trends identified, etc.

Exchange of information is said to cover all information that is foreseeably relevant to the administration or enforcement of the domestic

6 OECD, 2006. *Manual on the Implementation of Exchange of Information Provisions for Tax Purposes,* Module on General and Legal Aspects of Exchange of Information, p.4.
Source:http://www.oecd.org.,viewed on May 29, 2009.

7 It should be noted that the OECD's work on the issues of transparency and exchange of information in tax matters was given new impetus by the G20 and the process begun at the November 2008 summit meeting in Washington, D.C.
Source:http://www.oecd.org/LongAbstract/.,viewed on June 1, 2009.

8 The concept of "domestic tax interest" describes a situation where a contracting party can only provide information to another contracting party if it has an interest in the requested information for its own tax purposes. (OECD, 2006, op. cit, p.16)

9 OECD, 2006. Op. cit., pp. 7-8.

10 In order to improve the efficiency and effectiveness of automatic exchanges of information, the OECD has designed both a standard paper form and a standard electronic format (known as the OECD Standard Magnetic Format of "SMF"). The OECD has also designed a "new generation" transmission format for automatic exchange (known as the Standard Transmission Format or "STF") to eventually replace the SMF. *(Ibid.)*

laws of the contracting parties concerning taxes. Under Article 26 of the Model Convention or Article 1 of the 2002 Model Agreement on Exchange of Information on Tax Matters[11], request for information could include any or all of the following items:

a. Fiscal residence of an individual or a company;

b. Tax status of a legal entity;

c. Nature of income in the source country;

d. Income and expenses shown on a tax return;

e. Business records (for instance, to determine the amount of commissions paid to a company of another State);

f. Formation documents of an entity and documents about subsequent changes of shareholders/partners;

g. Name and address of the entity at the time of formation and all subsequent name and address changes;

h. Number of entities residing at the same address as the requested entity;

i. Names and addresses of the directors, managers, and other employees of a company for the relevant years, evidence (contracts and bank statements) of their remuneration, social security payments and information about their occupation with regard to any other entities;

j. Banking records;

k. Accounting records and financial statements;

l. Copies of invoices, commercial contracts, etc.;

m. Price paid for goods in a transaction between independent companies in both States;

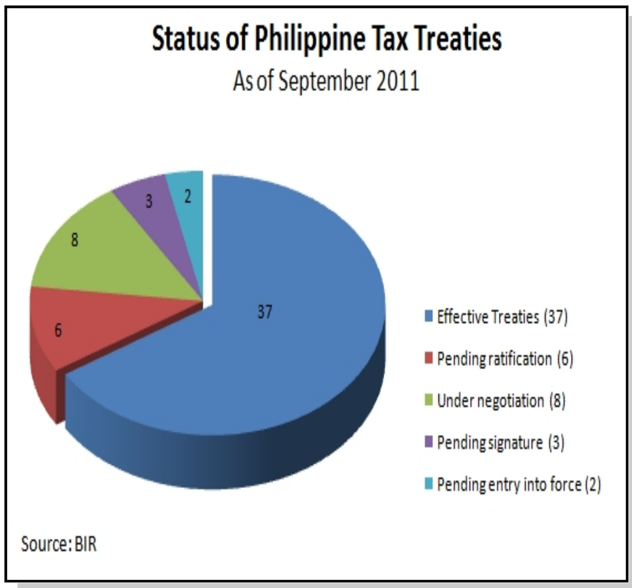
n. Information involving a so-called triangular situation wherein transactions between two companies, each situated in a contracting party, is interposed; and

o. Prices in general, necessary to check the prices charged by their taxpayers even if there are no business contracts between the taxpayers.

The scope of information exchange under the Model Convention and Model agreement also permits the exchange of confidential non-taxpayer specific information such as statistics, information about a particular industry, tax evasion trends, administrative interpretations and practices.[12]

B. COMMENTS/OBSERVATIONS

1. As of September 11, 2011, the Philippines has entered into tax treaties with fifty six (56) countries, of which thirty seven (37) are **"effective**" and nineteen (19) are in **various stages,**



2. Four (4) conventions, namely with Sri Lanka, Kuwait, Qatar, and Turkey are currently in the Philippine Senate for ratification. Pursuant to the 1987 Philippine Constitution, "*No treaty or international agreement shall be valid and effective unless concurred in by at least two-thirds of all the Members of the Senate".*

3. On the **RP-Sri Lanka** Convention on the Avoidance of Double Taxation, signed on 11 December 2000 in Manila

   3.1 The objective of the Convention is to promote international trade and investment, primarily allocating taxing jurisdiction between the Contracting States as to eliminate or mitigate double taxation on income. It is also intended to permit the Contracting States to better enforce their domestic laws in order to reduce tax evasion.

   3.2 The Convention shall apply to persons who are residents of one or both of the Contracting States.

   3.3 The Taxes covered on this Convention are (***Article 2***):

   - Taxes on income imposed on behalf of each Contracting State, irrespective of the manner in

11 This Model Agreement is focussed on information exchange upon request and does not cover spontaneous or automatic exchange of information.

12 OECD, 2006. Op. cit., pp. 10-11.

which they are levied;

- Taxes on income imposed on total income, or on elements of income, including taxes on gains from the alienation of movable or immovable property, and taxes on the total amounts of wages or salaries paid by enterprises;

- The existing taxes to which this Convention shall apply are:

  a) **Philippines** - the income taxes imposed by the Government of the Republic of the Philippines; and

  b) **Sri Lanka** – the income tax, including the income tax based on the turnover of enterprises licensed by the Greater Colombo Economic Commission.

3.4 The Department of Finance (DOF) and the Bureau of Internal Revenue (BIR) were **consulted** and have **concurred** with the Convention's ratification[13].

3.5 The Department of Foreign Affairs Secretary has certified that the draft Instrument of Ratification, are **true and correct copies of the official text of the Convention** between the Government of the Republic of the Philippines and the Government of the Democratic Socialist Republic of Sri Lanka for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income.

4. <u>On the **RP-Kuwait** Convention on the Avoidance of Double Taxation, signed on 3 November, 2009 in Kuwait.</u>

4.1 The objective of the Convention is to promote international trade and investment, primarily by allocating taxing jurisdiction between the Contracting States to eliminate or mitigate double taxation on income.

4.2 The convention shall apply to persons who are residents of one or both of the Contracting States.

4.3 The taxes covered on this Convention ***(Article 2)*** are:

- Taxes on income imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied;

- Taxes on income imposed on total income or on elements of income, including taxes on gains from the alienation of movable or immovable property, and taxes on the total amount of wages or salaries paid by enterprises.

- The existing taxes to which this Convention shall apply are, in particular:

  (a) **Philippines** – (1) the tax on individuals, (2) the tax on corporations, (3) the tax on estates and trusts; and (4) the withholding taxes.

  (b) **Kuwait** – (1) the corporate income tax, (2) the combination from net profits of the Kuwaiti shareholding companies payable to the Kuwait Foundation for Advancement of Science (KFAS); (3) the Zakat, and (4) the tax subjected according to the national employee law.

4.4 The DOF and BIR were **consulted** and have **concurred** with the Convention's ratification[14] .

4.5 The Department of Foreign Affairs Secretary has certified that the draft Instrument of Ratification, **are true and correct copies of the official text of the Convention** between the Government of the Republic of the Philippines and the Government of the State of Kuwait for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income.

5. <u>On the **RP-Qatar** Convention on the Avoidance of Double Taxation, signed on 14 December 2008 in Doha.</u>

5.1 The objective of the Convention is to promote international trade and investment, primarily by allocating taxing jurisdiction between the Contracting States to eliminate or mitigate double taxation on income. The Agreement intends to permit the Contracting States to better enforce their domestic laws in order to reduce tax evasion.

5.2 The convention shall apply to persons who are residents of one or both of the Contracting States.

5.3 The taxes covered on this Convention (***Article 2***) are:

- Taxes on income imposed on behalf

13 Per attached letter of then President Gloria Arroyo to the Senate President dated January 21, 2010.

14 14 Per attached letter to the Senate President dated May 27, 2010 by then President Gloria Macapagal Arroyo. Certification of Concurrence by concerned agencies and officials, namely: Hon. Margarito Teves, Secretary of the Department of Finance; Hon. Joel L. Tan-Torres, Commissioner of the Bureau of Internal Revenue (BIR); and Atty. Robert F. Bernardo, Chief of the International Tax Affairs Division of the BIR.

of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied;

- The existing taxes to which this Convention shall apply are, in particular:

  (a) **Philippines** – taxes imposed under the National Internal Revenue Code of the Philippines.

  (b) **Qatar** – the income tax ("Qatari Tax")

5.4. The DOF and BIR **were consulted and have concurred** with the Convention's ratification[15].

5.5. The Department of Foreign Affairs Secretary has certified that the draft Instrument of Ratification, **are true and correct copies of the official text of the Convention** between the Government of the Republic of the Philippines and the Government of the State of Qatar for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income.

6. <u>On the **RP-Turkey** Convention on the Avoidance of Double Taxation, signed on 18 March 2009 in Ankara.</u>

6.1 The objective of the Convention is to promote international trade and investment, primarily by allocating taxing jurisdiction between the Contracting States to eliminate or mitigate double taxation on income. The Agreement assists the Contracting States to better enforce their domestic tax laws and reduce tax evasion.

6.2 The convention shall apply to persons who are residents of one or both of the Contracting States.

6.3 The taxes covered on this Convention (***Article 2***) are, in particular:

- Taxes on income imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied;

- Taxes on income imposed on total income or on elements of income, including taxes on gains from the alienation of movable or immovable property, and taxes on the total amount of wages or salaries paid by enterprises.

- The existing taxes to which this Convention shall apply are, in particular:

  (a) **Philippines** – (1) the income taxes imposed under Title II and the stock transaction tax in accordance with Section 127 of the Tax Reform Act of 1997.

  (b) **Turkey**– (1) the income tax, (2) the corporation tax, (3) the levy imposed on the income tax and the corporation tax ("Turkish tax").

6.4 The BIR has **been consulted and concurred with the ratification** of the Agreement between the Republic of the Philippines and the Republic of Turkey for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and its Annexed Protocol.

6.5. The Department of Foreign Affairs Secretary has certified that the draft Instrument of Ratification, **are true and correct copies of the official text of the Convention** between the Government of the Republic and the Government of the Republic of Turkey for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income.

7. The provisions in the aforementioned Conventions, particularly "***Article 2– Taxes Covered"*** are similar with other existing Conventions/Treaties the Philippine Government has ratified/concurred.

   However, in the case of the Convention with Turkey, there is included in the Philippines a "**stock transaction tax".** Per verification with the BIR International Tax Division, there are already agreements with similar provision and can be found in the tax treaties with Switzerland, Bangladesh, United Arab Emirates, Sweden, France, Denmark, Belgium, and Austria.

8. The BIR Revenue Memorandum Order No. 72-2010 issued on August 25, 2010 prescribes the Guidelines on the Processing of Tax Treaty Relief Applications (TTRA) pursuant to existing Philippine Tax Treaties.

   The tax treaty application should include the following requirements:

   - Proof of Residency
   - Articles of Incorporation (for income earner other than an individual)
   - Special Power of Attorney
   - Certification of Business Presence in the Philippines
   - Certificate of No Pending Case

15 Per attached Certification of Concurrence by concerned agencies and officials, namely: Hon. Cesar V. Purisima of the DOF; Hon. Kim S. Jacinto-Henares, Commissioner of the BIR; and Atty. Robert F. Bernardo, Chief of the BIR International Tax Affairs Division.

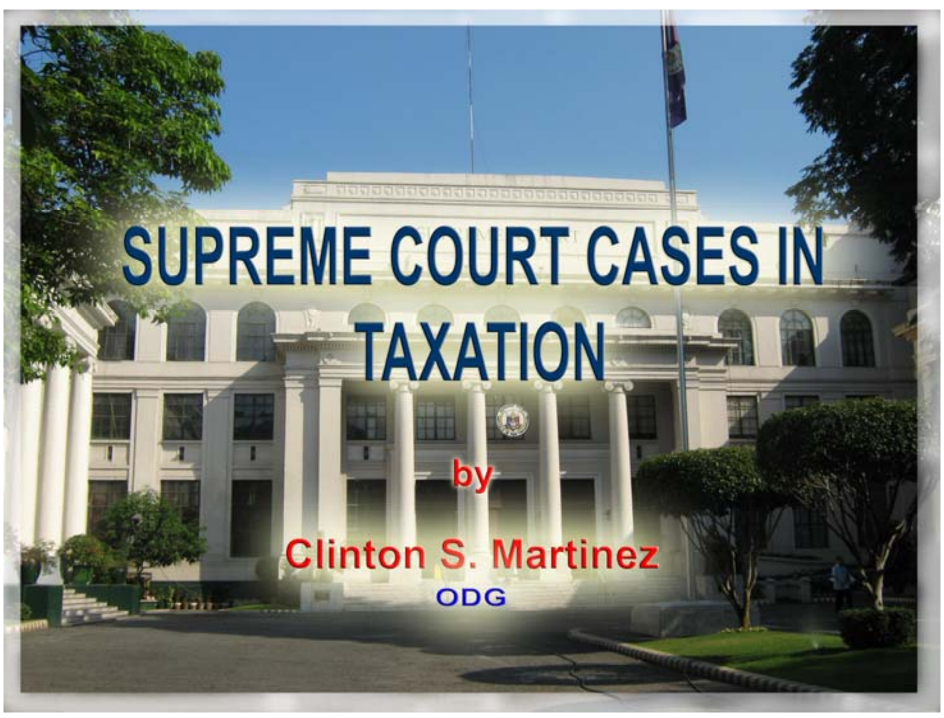
The following BIR Forms should be duly filled out by the tax treaty applicant and should be submitted and received by the BIR International Tax Affairs Division:

BIR Form	Nature of Tax Treaty Application
0901-C	Application For Relief From Double Taxation on Capital Gains
0901-D	Tax Treaty Relief Application for Dividend Income
0901-I	Application For Reli8ef From Double Taxation on Interest Income;
0901-O	Tax Treaty Relief Application for Other Income Earnings
0901-P	Tax Treaty Relief Application for Business Profits;
0901-R	Tax Treaty Relief Application for Royalty Income
0901-S	Tax Treaty Relief Application for Income from Services;
0901-T	Application for Relief From Double Taxation on Shipping and Air Transport;

Conclusion and Recommendations

The said four (4) Conventions will further give life in the implementation of Republic Act No. 10021 known as the "Exchange of Information". This law was enacted by Congress on 5 March 2010 to comply with the Internationally Agreed Standard (IATS) for Exchange of Information to more effectively carry out the country's commitments under bilateral treaties designed to combat tax abuses. The exchange of information is a key element to international cooperation in tax matters. The aforementioned Treaties/Conventions with Sri Lanka, Kuwait, Qatar and Turkey also include provision on Exchange of Information (Article 26 for Sri Lanka, Qatar, and Turkey; and Article 25 for Kuwait).

In summary, entering into a treaty with another country will promote international trade and investment, primarily allocating taxing jurisdiction between the Contracting States to eliminate or mitigate double taxation on income. This will likewise permit the Contracting States to better enforce their domestic laws in order to reduce tax evasion.



COMMISSIONER OF INTERNAL REVENUE, *Petitioner*, vs. SMART COMMINICATION, INC., *Respondent* (G.R. Nos. 179045-46; August 25, 2010; Del Castillo, *J.*)

Facts:

Respondent Smart Communications, Inc. (Smart), is a corporation established and operating pursuant to the laws of the Republic of the Philippines (RP), and is an enterprise duly registered with the Board of Investments (BOI).

Respondent Smart, on 25 May 2001, entered into three (3) Agreements for Programming and Consultancy and Services with Prism Transactive Sdn. Bhd, a non-resident corporation duly organized and existing under Malaysian laws. As a consequence of the said agreement, Prism billed Smart as follows:

SDM Agreement	US $236,000.00
CM Agreement	296,000.00
SIM Application	15,822.45
TOTAL	US $547,822.45

Respondent withheld the amount of US$136,955.61 or P7,008,840.43 representing the 25% royalty tax under the RP-Malaysia Treaty. Respondent filed its Monthly Remittance Return of Final Income Taxes Withheld for August 2011 on September 25, 2001. On September 24, 2003 Smart filed an administrative claim for refund with the BIR of the amount mentioned above.

The Commissioner of Internal Revenue (CIR) failed to act on the claim. Smart filed a Petition for Review with the Court of Tax Appeals (CTA) [2nd Division], stressing that payments made to Prism are not royalties but business profits, as per RP-Malaysia Tax Treaty. Under Article 7 of the Treaty, business profits are taxable in the Philippines only if attributable to a permanent establishment in RP, hence payments made to Prism a Malaysian company with no such edifice should not be taxed.

The CIR on 1 December 2003 filed his Answer alleging that Smart, as withholding agent, is not a party-in-interest to file the claim for refund citing several cases.

The CTA 2nd Division in a decision dated 23 February 2006 upheld Smart's rights to file the claim for refund, as withholding agent. However, it declared that the payment made for the SDM Agreement is in the nature of royalty subject to withholding tax. Hence the refund awarded to Smart only totaled P3,989,456.43.

The CTA *En Banc* rendered a decision affirming the partial refund and proferred "that although respondent and Prism are unrelated entities, such circumstance does not affect the status of [respondent] as a party-in-interest [as its legal interest] is based on its direct and independent liability under the withholding tax system."

Issues:

1. Whether respondent Smart has the right to file the claim for refund; and

2. If respondent Smart has the right, whether the payments made to the Malaysian firm constitute *business profits* or royalties.

Held:

The Supreme Court (SC) proclaimed that "The petition is bereft of merit."

The SC cited the following provisions of the National Internal Revenue Code (NIRC), as amended:

> *"Sec. 204. Authority of the Commissioner to Compromise, Abate and Refund or Credit Taxes. - The Commissioner may –*
>
> *"(C) Credit or refund taxes erroneously or illegally received or penalties imposed without authority, refund the value of internal revenue stamps when they are returned in good condition by the purchaser, and, in his discretion, redeem or change unused stamps that have been rendered unfit for use and refund their value upon proof of destruction. No credit or refund of taxes or penalties shall be allowed unless the taxpayer filed in writing with the Commissioner a claim for credit or refund within two (2) years after the payment of the tax or penalty: Provided, however, That a return filed showing an overpayment shall be considered as a written claim for credit or refund.*
>
> *"Sec. 229. Recovery of Tax Erroneously or Illegally Collected. - No suit or proceeding shall be maintained in any court for the recovery of any national internal revenue tax hereafter alleges to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessively or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Commissioner; but such suit or proceeding may be maintained, whether or not such tax, penalty, or sum has been paid under protest or duress.*
>
> *"In any case, no such suit or proceeding shall be filed after the expiration of two (2) years from the date of payment of the tax or penalty regardless of any supervening cause that may arise after payment: Provided, however, That the Commissioner may, even without written claim therefor, refund or credit any tax, where on the face of the return upon which payment was made, such payment appears clearly to have been erroneously paid."*

The SC declared that *"Pursuant to the foregoing, the person entitled to claim a tax refund is the taxpayer. However, in case the taxpayer does not file a claim for refund, the withholding agent may file the claim."*

The SC cited its decision in the case of *Commissioner of Internal Revenue v. Procter & Gamble Philippine Manufacturing Corporation*:

> *"The term 'taxpayer' is defined in our NIRC as referring to 'any person subject to tax imposed by the Title [on Tax on Income].' It thus becomes important to note that under Section 53(c)[1] of the NIRC, the withholding agent who is 'required to deduct and withhold any tax' is made 'personally liable for such tax' and indeed is indemnified against any claims and demands which the stockholder might wish to make in questioning the amount of payments effected by the withholding agent in accordance with the provisions of the NIRC. The withholding agent, P&G-Phil., is directly and independently liable for the correct amount of the tax that should be withheld from the dividend remittances. The withholding agent is, moreover, subject to and liable for deficiency assessments, surcharges and penalties should the amount of the tax withheld be finally found to be less than the amount that should have been withheld under the law."*
>
> The Court further explained:
>
> *"Although such relation between the taxpayer and the withholding agent is a factor that increases the latter's legal interest to file a claim for refund, there is nothing in the decision to suggest that such relationship is required or that the lack of such relation deprives the withholding agent of the right to file a claim for refund. Rather, what is clear in the decision is that a withholding agent has a legal right to file a claim for refund for two reasons. First, he is considered*

1 Section 57.

a 'taxpayer' under the NIRC as he is personally liable for the withholding tax as well as for deficiency assessments, surcharges, and penalties, should the amount of the tax withheld be finally found to be less than the amount that should have been withheld under the law. Second, as an agent of the tax-payer, his authority to file the necessary income tax return and to remit the tax withheld to the government impliedly includes the authority to file a claim for refund and to bring an action for recovery of such claim."

With respect to the other issue involving 'business profits', the SC ruled:

"In the instant case, it was established during the trial that Prism does not have a permanent establishment in the Philippines. Hence, 'business profits' derived from Prism's dealings with respondent are not taxable. The question is whether the payments made to Prism under the SDM, CM and SIM Application agreements are 'business profits' and not royalties."

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

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

"The provisions in the agreements are clear. Prism has intellectual property right over the SDM program, but not over the CM and SIM Application programs as the proprietary rights of these programs belong to respondent. In other words, out of the payments made to Prism, only the payment for the SDM program is a royalty subject to a 25% withholding tax. A refund of the erroneously withheld royalty taxes for payments pertaining to the CM and SIM Application Agreements is therefore in order."

The Petition of the CIR was denied and the BIR was ordered to pay respondent Smart the amount of P3,989.456.43 representing the overpaid final withholding taxes for the month of August 2001.

COMMISSIONER OF INTERNAL REVENUE, *Petitioner* vs. THE PHILIPPINE AMERICAN LIFE AND GENERAL INSURANCE COMPANY, *Respondent* (G.R. No. 175124; September 29, 2010; Carpio, *J.*)

Facts:

Respondent in this case filed with the BIR on April 15, 1998 its annual Income Tax Return (ITR) for taxable year 1997. It declared a net loss of P165,701,508.00.

On December 16, 1999, respondent filed a claim for refund in the sum of P9,326,979.35 with the BIR-Appellate Division (AD). Said amount, it is alleged, represents the creditable taxes withheld and remitted to the BIR by respondent's withholding agents from rentals and real property dividend for the year 1997.

Respondent filed with the Court of Tax Appeals (CTA) a petition for review (December 23, 1999) when BIR-AD failed to act on its claim. Respondent alleges that the sum represents a portion of its overpaid and unapplied creditable taxes for 1997. Respondent attached its ITR for 1998 to its Memorandum (January 7, 2002). The CTA, in its decision dated June 4, 2002, denied respondent's claim for lack of merit because of its failure to present its 1998 ITR. The CTA likewise denied respondent's Motion for Reconsideration (MR) [October 2, 2002].

Respondent appealed to the Court of Appeals (CA) which reversed the decision and resolution of the CTA (June 26, 2006). In fine, the CA decision ordered the refund of the sum of P9,326.979.35 representing petitioner's (Philam Life) overpayment and unapplied creditable withholding tax for the taxable year 1997.

The Commissioner of Internal Revenue's (CIR) MR was denied by the CA in a Resolution dated October 12, 2006.

Issue:

Whether Respondent Philippine American Life and General Insurance Company is entitled to a refund of its excess income tax credit even if it had already opted to carry-over the excess income tax credit against the tax due in the succeeding taxable years.

Held:

The Supreme Court (SC) decided in favor of petitioner CIR. It resolved that the case involves the application of Section 76 of the National Internal Revenue Code (NIRC) of 1997, as amended. The same provides:

> *"SEC. 76. - Final Adjustment Return. - Every corporation liable to tax under Section 27 shall file a final adjustment return covering the total taxable income for the preceding calendar or fiscal year. If the sum of the quarterly tax payments made during the said taxable year is not equal to the total tax due on the entire taxable income of that year, the corporation shall either:*
>
> *"(A) Pay the balance of tax still due; or*
>
> *"(B) Carry-over the excess credit; or*
>
> *"(C) Be credited or refunded with the excess amount paid, as the case may be.*
>
> *"In case the corporation is entitled to a tax credit or refund of the excess estimated quarterly income taxes paid, the excess amount shown on its final adjustment return may be carried over and credited against the estimated quarterly income tax liabilities for the taxable quarters of the succeeding taxable years. Once the option to carry-over and apply the excess quarterly income tax against income tax due for the taxable quarters of the succeeding taxable years has been made, such option shall be considered irrevocable for that taxable period and no application for cash refund or issuance of a tax credit certificate shall be allowed therefor."*

Moreover, the Court pronounced:

> *"In this case, it is undisputed that respondent indicated in its 1997 ITR its option to carry-over as tax credit for the next year its overpayment. In its 1998 ITR, respondent again indicated its preference to carry-over the excess income tax credit against the tax liabilities for the succeeding taxable years. Clearly, respondent chose to carry-over and apply the overpaid tax against the income tax due in the succeeding taxable years. Under Section 76 of the NIRC of 1997, once the taxpayer exercises the option to carry-over and apply the excess creditable tax against the income tax due for the succeeding taxable years, such option is irrevocable. Thus, respondent can no longer claim a refund of its excess income tax credit in the taxable year 1997 because it has already opted to carry-over the excess income tax credit against the tax due in the succeeding taxable years."*

The SC granted the petition of CIR and ordered the reinstatement of the June 4, 2002 Decision and October 2, 2002 Resolution of the CTA.

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