

FIRST DIVISION

[G.R. Nos. 179045-46, August 25, 2010]

COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS. SMART COMMUNICATION, INC.,* RESPONDENT.

D E C I S I O N

DEL CASTILLO, J.:

The right of a withholding agent to claim a refund of erroneously or illegally withheld taxes comes with the responsibility to return the same to the principal taxpayer.

This Petition for Review on *Certiorari* under Rule 45 of the Rules of Court seeks to set aside the Decision^[1] dated June 28, 2007 and the Resolution^[2] dated July 31, 2007 of the Court of Tax Appeals (CTA) *En Banc*.

Factual Antecedents

Respondent Smart Communications, Inc. is a corporation organized and existing under Philippine law. It is an enterprise duly registered with the Board of Investments.

On May 25, 2001, respondent entered into three Agreements for Programming and Consultancy Services^[3] with Prism Transactive (M) Sdn. Bhd. (Prism), a non-resident corporation duly organized and existing under the laws of Malaysia. Under the agreements, Prism was to provide programming and consultancy services for the installation of the Service Download Manager (SDM) and the Channel Manager (CM), and for the installation and implementation of Smart Money and Mobile Banking Service SIM Applications (SIM Applications) and Private Text Platform (SIM Application).

On June 25, 2001, Prism billed respondent in the amount of US\$547,822.45, broken down as follows:

SDM Agreement	US\$236,000.00
CM Agreement	296,000.00
SIM Application Agreement	15,822.45
Total	US\$547,822.45 ^[4]

Thinking that these payments constitute royalties, respondent withheld the amount of US\$136,955.61 or P7,008,840.43,^[5] representing the 25% royalty tax under the RP-Malaysia Tax Treaty.^[6]

On September 25, 2001, respondent filed its Monthly Remittance Return of Final

Income Taxes Withheld (BIR Form No. 1601-F)^[7] for the month of August 2001.

On September 24, 2003, or within the two-year period to claim a refund, respondent filed with the Bureau of Internal Revenue (BIR), through the International Tax Affairs Division (ITAD), an administrative claim for refund^[8] of the amount of P7,008,840.43.

Proceedings before the CTA Second Division

Due to the failure of the petitioner Commissioner of Internal Revenue (CIR) to act on the claim for refund, respondent filed a Petition for Review^[9] with the CTA, docketed as CTA Case No. 6782 which was raffled to its Second Division.

In its Petition for Review, respondent claimed that it is entitled to a refund because the payments made to Prism are not royalties^[10] but "business profits,"^[11] pursuant to the definition of royalties under the RP-Malaysia Tax Treaty,^[12] and in view of the pertinent Commentaries of the Organization for Economic Cooperation and Development (OECD) Committee on Fiscal Affairs through the Technical Advisory Group on Treaty Characterization of Electronic Commerce Payments.^[13] Respondent further averred that since under Article 7 of the RP-Malaysia Tax Treaty, "business profits" are taxable in the Philippines "only if attributable to a permanent establishment in the Philippines, the payments made to Prism, a Malaysian company with no permanent establishment in the Philippines,"^[14] should not be taxed.^[15]

On December 1, 2003, petitioner filed his Answer^[16] arguing that respondent, as withholding agent, is not a party-in-interest to file the claim for refund,^[17] and that assuming for the sake of argument that it is the proper party, there is no showing that the payments made to Prism constitute "business profits."^[18]

Ruling of the CTA Second Division

In a Decision^[19] dated February 23, 2006, the Second Division of the CTA upheld respondent's right, as a withholding agent, to file the claim for refund citing the cases of *Commissioner of Internal Revenue v. Wander Philippines, Inc.*,^[20] *Commissioner of Internal Revenue v. Procter & Gamble Philippine Manufacturing Corporation*^[21] and *Commissioner of Internal Revenue v. The Court of Tax Appeals*.^[22]

However, as to the claim for refund, the Second Division found respondent entitled only to a partial refund. Although it agreed with respondent that the payments for the CM and SIM Application Agreements are "business profits,"^[23] and therefore, not subject to tax^[24] under the RP-Malaysia Tax Treaty, the Second Division found the payment for the SDM Agreement a royalty subject to withholding tax.^[25] Accordingly, respondent was granted refund in the amount of P3,989,456.43, computed as follows:^[26]

Particulars	Amount (in US\$)
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1. CM	296,000.00
2. SIM Application	15,822.45
Total	US\$311,822.45

Particulars	Amount
Tax Base	US\$311,822.45
Multiply by: Withholding Tax Rate	25%
Final Withholding Tax	US\$ 77,955.61
Multiply by: Prevailing Exchange Rate	51.176
Tax Refund Due	P3,989,456.43

The dispositive portion of the Decision of the CTA Second Division reads:

WHEREFORE, premises considered, the instant petition is partially GRANTED. Accordingly, respondent Commissioner of Internal Revenue is hereby ORDERED to REFUND or ISSUE a TAX CREDIT CERTIFICATE to petitioner Smart Communications, Inc. in the amount of P3,989,456.43, representing overpaid final withholding taxes for the month of August 2001.

SO ORDERED.^[27]

Both parties moved for partial reconsideration^[28] but the CTA Second Division denied the motions in a Resolution^[29] dated July 18, 2006.

Ruling of the CTA En Banc

Unsatisfied, both parties appealed to the CTA *En Banc* by filing their respective Petitions for Review,^[30] which were consolidated per Resolution^[31] dated February 8, 2007.

On June 28, 2007, the CTA *En Banc* rendered a Decision affirming the partial refund granted to respondent. In sustaining respondent's right to file the claim for refund, the CTA *En Banc* said 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."^[32] The CTA *En Banc* also concurred with the Second Division's characterization of the payments made to Prism, specifically that the payments for the CM and SIM Application Agreements constitute "business profits,"^[33] while the payment for the SDM Agreement is a royalty.^[34]

The dispositive portion of the CTA *En Banc* Decision reads:

WHEREFORE, the instant petition is hereby DISMISSED. Accordingly, the assailed Decision and Resolution are hereby AFFIRMED.

SO ORDERED.^[35]

Only petitioner sought reconsideration^[36] of the Decision. The CTA *En Banc*, however, found no cogent reason to reverse its Decision, and thus, denied petitioner's motion for reconsideration in a Resolution^[37] dated July 31, 2007.

Unfazed, petitioner availed of the present recourse.

Issues

The two issues to be resolved are: (1) whether respondent has the right to file the claim for refund; and (2) if respondent has the right, whether the payments made to Prism constitute "business profits" or royalties.

Petitioner's Arguments

Petitioner contends that the cases relied upon by the CTA in upholding respondent's right to claim the refund are inapplicable since the withholding agents therein are wholly owned subsidiaries of the principal taxpayers, unlike in the instant case where the withholding agent and the taxpayer are unrelated entities. Petitioner further claims that since respondent did not file the claim on behalf of Prism, it has no legal standing to claim the refund. To rule otherwise would result to the unjust enrichment of respondent, who never shelled-out any amount to pay the royalty taxes. Petitioner, thus, posits that the real party-in-interest to file a claim for refund of the erroneously withheld taxes is Prism. He cites as basis the case of *Silkair (Singapore) Pte, Ltd. v. Commissioner of Internal Revenue*,^[38] where it was ruled that the proper party to file a refund is the statutory taxpayer.^[39] Finally, assuming that respondent is the proper party, petitioner counters that it is still not entitled to any refund because the payments made to Prism are taxable as royalties, having been made in consideration for the use of the programs owned by Prism.

Respondent's Arguments

Respondent, on the other hand, maintains that it is the proper party to file a claim for refund as it has the statutory and primary responsibility and liability to withhold and remit the taxes to the BIR. It points out that under the withholding tax system, the agent-payor becomes a payee by fiction of law because the law makes the agent personally liable for the tax arising from the breach of its duty to withhold. Thus, the fact that respondent is not in any way related to Prism is immaterial.

Moreover, respondent asserts that the payments made to Prism do not fall under the definition of royalties since the agreements are for programming and consultancy services only, wherein Prism undertakes to perform services for the creation, development or the bringing into existence of software applications solely for the satisfaction of the peculiar needs and requirements of respondent.

Our Ruling

The petition is bereft of merit.

Withholding agent may file a claim for refund

Sections 204(c) and 229 of the National Internal Revenue Code (NIRC) provide:

Sec. 204. Authority of the Commissioner to Compromise, Abate, and Refund or Credit Taxes. - The Commissioner may -

x x x x

(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 files 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.

x x x x

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 alleged 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 a 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. (Emphasis supplied)

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.

In *Commissioner of Internal Revenue v. Procter & Gamble Philippine Manufacturing Corporation*,^[40] a withholding agent was considered a proper party to file a claim for refund of the withheld taxes of its foreign parent company. Pertinent portions of the Decision read: