A CALL FOR RE-EVALUATION: PRIOR TAX TREATY RELIEF APPLICATION*

*Jesusa Loreto A. Arellano-Aguda***

ABSTRACT

This article examines the administrative procedures and requirements imposed by the Bureau of Internal Revenue for taxpayers to be able to avail themselves of reliefs provided under applicable tax treaties. In particular, this article looks at and assesses the prevailing system of mandatory prior applications for tax treaty relief and tax rulings in light of the international obligations of the Philippines under various treaties. This article posits that, despite the laudable objectives of the prevailing system as regards procedural efficiency and streamlined service, the substantive rights of taxpayers under international treaties are effectively impaired and overridden, in violation of international

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The requirement for a prior application for tax treaty reliefs is a subject that has already been discussed by Philippine authors. Blogs (*see, e.g.* Arnold S., *Tax treaty relief application guidelines*, *in* Philippine Tax Updates, *at* http://philtaxupdates.blogspot.com/2010/09/tax-treaty-relief-application.html; *Tax treaty relief applications—to file or not to file?*, Herald Digital Law Philippines, *at* http://philippineslaw.wordpress.com/2011/01/18/tax-treaty-applications-to-file-or-not-to-file/) and professional partnership websites (*see, e.g. New guidelines for tax treaty relief: a welcome break for taxpayers?*, Punongbayan & Araullo Website, at http://www.punongbayan-araullo.com/pnawebsite/pnahome.nsf/section_docs/IV643A_6-12-10) have provided informative short articles on the BIR issuances. Recently, Carlo Olivar and Jesus Malcolm Madriaga published an academic article, Administrative Tax Rule Requiring Prior Tax Treaty Relief Application is a Tax Treaty Override (56 ATENEO L.J. 855 [2012]) which criticizes the prior application requirement not only as a tax treaty override, but also as an *ultra vires* administrative rule.

This paper presents its own analysis of the problem, but likewise arrives at the conclusion that, apart from being a treaty override, the prior application requirement defeats the policy behind tax treaties. At the same time, this article goes beyond offering a critique of the BIR requirements by proposing a workable framework for the implementation of tax treaties. Nevertheless, for a complete and holistic understanding of the legal and policy implications of requiring prior applications for tax treaty relief, this article still goes through the exercise of presenting a concise background of the issue and criticizing the BIR issuances as treaty overrides before proceeding to a detailed recommendation.

** LL.M., Harvard University (2013); J.D., *cum laude* and College of Law Salutatorian, University of the Philippines (2008). Chief Financial Officer, Alphaland Corp. and Atok-Big Wedge Co., Inc.; Senior Lecturer, College of Law, University of the Philippines.

law and to the detriment of the country's prospects for economic growth and development. Ultimately, this article calls for a reevaluation of the prevailing system, and recommends that an advance tax ruling system based on that prevailing in the US be adopted or developed in its stead.

I. INTRODUCTION

The Philippines is touted to be one of the fasting growing economies in the world. A major reason for this is the amount of foreign direct investment ("FDI") that comes into the Philippines. Handsome tax incentives help guarantee the continuous inflow of FDI into the country. The availability of tax treaty benefits makes the country more attractive to foreign investors. Thus, the process by which foreign investors, and taxpayers in general, can avail themselves of tax treaty relief is significant to the Philippines' continued economic growth.

To avoid the consequences of wrongful application and interpretation of tax treaty provisions, the Bureau of Internal Revenue (BIR), the administrative body in charge of the enforcement of tax laws in the Philippines, requires a taxpayer to first secure a confirmatory ruling from its International Tax Affairs Division (ITAD) before he can avail himself of the tax treaty benefits under Revenue Memorandum Order ("RMO") No. 1-2000, as amended by RMO No. 72-2010. Failure to do so disqualifies the taxpayer from availing himself of the tax treaty relief and bars him from getting a refund for excess taxes paid, even if it is eventually shown that he is qualified for preferential tax treatment or tax exemptions under the treaty.

The problem is that the BIR issues rulings to taxpayers after more than one year, on average, from the date of the filing of the application. As a result, cross-border transactions and foreign investments are derailed. Taxpayers, due to time and financial constraints, sometimes have no choice but to forego the benefits under relevant treaties. On the other hand, some taxpayers are forced to explore other avenues, such as offering financial incentives to BIR officials, in order to speed up the application process, knowing the reputation of the BIR as one of the most corrupt government agencies in the Philippines.[1] Thus, there is

[1] As of the March 2011 survey of Pulse Asia, Inc., the Bureau of Internal Revenue is the fourth most corrupt government agency in the Philippines. *See* Ana Maria Tabunda, *Media Release: Pulse Asia's March 2011 Nationwide Survey on Corruption*, PulseAsia.com, Mar. 28, 2011, *at*, http://www.pulseasia.ph/files/Download/3-28-2011%20MR3%20-%20UB2011-1%20MR%20on%20Corruption.pdf (last visited Mar. 29, 2014).

a clamor by tax practitioners and taxpayers alike for the removal and/or amendment of the prior application for tax treaty relief requirement, notwithstanding its validation by the courts.

This paper will examine the requirement that a taxpayer make a prior application for tax treaty relief, its validity, and feasibility. To this end, after this introduction, this paper presents the nature of Philippine tax treaties in general, its purpose, and interpretation. Part III lays out the history of prior tax treaty relief application and ruling, its procedure, and its effect. Part IV critiques the prior tax treaty relief application requirement and identifies the main arguments against its continuation. Part V evaluates the current tax ruling system in the Philippines and suggests a framework for its possible improvement by looking at the existing practice of the United States and other countries. The final section summarizes and concludes the discussion.

II. BACKGROUND

A. Nature and Purpose of Tax Treaties

Tax treaties are formal international agreements between sovereign states with the primary objective of avoiding double taxation and preventing fiscal evasion. As early as 1974, the Philippines started to enter into tax treaties with other countries. Now, it is party to bilateral tax treaties with 37 contracting states.[2] Similar to other developing countries, the Philippines entered into these treaties to encourage foreign investment to spur the growth of its economy. As explained by the Supreme Court of the Philippines:

> 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.

In the Corruption Perception Index 2012 of Transparency International, the Philippines ranked 105 of 176 countries. *See* Transparency International, *Corruption Perception Index 2012*, *at* http://cpi.transparency.org/cpi2012/results/ (last visited Mar. 29, 2014).

[2] In order of entry into force: , Canada, Singapore, United Kingdom, France, Pakistan, Australia, Japan, Belgium, New Zealand, Pakistan, Finland, Austria, United States, Thailand, Malaysia, Germany, Republic of Korea, Sweden, Italy, Brazil, Netherlands, Indonesia, India, Spain, Denmark, Hungary, Poland, Israel, Russian Federation, Norway, Romania, China, Switzerland, Czech Republic, Vietnam, Bahrain, Bangladesh, Sweden, and United Arabs Emirates. Department of Foreign Affairs, *Philippine Treaties Online*, DFA.gov.ph, *at* https://www.dfa.gov.ph/treaty/index.php?r=treaty%2Fsearch&Treaty%5Btitle%5D=&Treaty%5Bcategory_id%5D=9&Treaty%5Bdate_of_signature%5D=&Treaty%5Bdate_of_entry_into_force%5D=&Treaty%5Bcontracting_party_id%5D=&yt0=Search (last visited Apr. 29, 2014).

> More precisely, the tax conventions are drafted with a view towards the elimination of international juridical double taxation, which is defined as the imposition of comparable taxes in two or more states on the same taxpayer in respect of the same subject matter and for identical periods. The apparent rationale for doing away with double taxation is to *encourage the free flow of goods and services and the movement of capital, technology and persons between countries, conditions deemed vital in creating robust and dynamic economies. Foreign investments will only thrive in a fairly predictable and reasonable international investment climate and the protection against double taxation is crucial in creating such a climate.*[3]

B. Tax Treaty Interpretation

Tax treaties are interpreted pursuant to existing norms of customary international law, which have been codified in the Vienna Convention on the Law of Treaties ("VCLT"). Thus, the VCLT is binding on all treaty parties, whether they are signatories or non-signatories of the convention.[4] The VCLT 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."[5] Further, a "party may not invoke the provisions of internal law as justification for its failure to perform a treaty."[6] Under the principle of *pacta sunt servanda,* "[e]very treaty in force is binding upon the parties to it and must be performed by them in good faith."[7] Hence, a contracting state, like the Philippines, is required to respect and perform its obligations under the tax treaty and can expect the other contracting state to do the same.

In the Philippines, treaties are ratified by the President and concurred in by at least two-thirds of the Senate in order to enter into force.[8] Through transformation, treaties become part of the law of the land and are of the same level and applied as a statute.[9] Nonetheless, treaties may be invalidated by the Supreme Court if they are found to be unconstitutional or if they violate existing

[3] Comm'r of Internal Revenue v. S.C. Johnson & Son, Inc., G.R. No. 127105, 309 SCRA 87, Jun. 25, 1999. (Emphasis supplied.)

[4] I ROY ROHATGI, BASIC INTERNATIONAL TAXATION 27 (2005).

[5] Vienna Convention on the Law of Treaties [hereinafter "VCLT"], May 23, 1969, art. 31, 1151 U.N.T.S. 331. This entered into force on Jan. 27, 1980.

[6] VCLT art. 27.

[7] VCLT, art. 26.

[8] *See* CONST., art VII, § 2. *See also* Exec. Order No. 459 (1997); this provides for guidelines in the negotiation of international agreements and their ratification.

[9] Abbas v. Commission on Elections, G.R. No. 89651, 179 SCRA 287, Nov. 10, 1989.

or subsequent statutes.[10] Notwithstanding this, pursuant to general principles of international law, which the Philippines adopts as part of the law of the land, it "becomes obligatory and incumbent" on the part of the government to be bound by the terms of the treaty.[11]

III. PRIOR TAX TREATY RELIEF APPLICATION

Prior to 1986, a taxpayer thinking of availing himself of the benefits of a tax treaty, including the application of preferential tax rates, may do so by just studying the applicability of a treaty provision, filing the appropriate tax return and, if there is any tax due, paying it pursuant to the treaty. There was no need to file an application for tax treaty relief with the BIR or wait for its ruling granting the request of a taxpayer to avail oneself of treaty benefits.[12]

In 1986, the BIR issued RMO No. 2-1986, which prescribes the procedure for filing and processing tax treaty relief applications ("TTRAs"). This was amended by RMO No. 10-1992, and then by RMO No. 1-2000. RMO No. 1-2000 gives the following objectives for its issuance: (1) streamline the processing of the TTRA in order to improve efficiency and service to the taxpayers; and (2) avert the consequences of any erroneous interpretation and/or application of the treaty provisions before proceeding with the transaction and or paying the tax liability covered by the tax treaty.

RMO No. 1-2000 requires that, in order to avail himself of tax treaty relief, including claims or requests for tax exemption, preferential tax treaty rate, and refund or credit of taxes, the taxpayer file at least 15 days prior to the transaction an Application for Relief from Double Taxation with all the supporting documents justifying the relief sought to the ITAD of the BIR.

Since the RMO does not provide for any consequences for the non-filing of the TTRA, taxpayers are faced with the question of whether the filing of the TTRA prior to availing of the tax treaty relief is mandatory. What

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[10] VICTORINO C. MAMALATEO, PHILIPPINE TAX TREATIES 17-18 (2010), *citing* CONST. art. VIII, § 5(2)(a) *and* Gonzales v. Hechanova, G.R. No. 21897, 9 SCRA 230, Oct. 22, 1963.

[11] Bayan v. Zamora, G.R. No. 138570, 342 SCRA 449, Oct. 10, 2000.

[12] Note though that in the case of the Republic of the Philippines ("RP")-Singapore Tax Treaty, the BIR issued Revenue Regulation No. 7-82, dated Aug. 1, 1982, to implement the said treaty and provide a procedure for the filing of an application to claim its benefits. The taxpayer has to file appropriate BIR application forms to get income tax relief. However, the regulation does not provide any timeframe for filing nor the consequence or penalty for failure to file the application. Further, requests for rulings are optional if a person wishes to avail himself of benefits where the forms are inapplicable.

happens if they fail to file the TTRA or if they file it after they have already availed themselves of the benefits?

The Court of Tax Appeals (CTA) answered these questions in *Mirant (Philippines) Operations Corporation v. Commissioner of Internal Revenue.*[13] This case involves a claim for refund for the alleged erroneous remittance of final withholding taxes of two foreign corporations. Mirant is a Philippine corporation engaged in the business of converting coal, distillate, and other fuel into electricity. VHL Enterprises ("VHL") and WES World-wide Education Service Ltd. ("WES") are foreign corporations with head offices in the United States and United Kingdom, respectively. These corporations rendered hands-on training, instructional, and/or consultancy services to the employees of Mirant for periods aggregating more than 183 days within a twelve-month period. For December 1999 and for various months of 2000, Mirant paid to the BIR the total amount of PHP 20,088,435.78, representing final taxes withheld from VHL and WES. In 2001, Mirant, believing that it had erroneously withheld and remitted the above final withholding taxes instead of the 5% creditable withholding taxes, availed itself of the BIR's Voluntary Assessment Program and paid the amount of PHP 4,845,082.09 as creditable withholding taxes. It subsequently filed a claim for refund with the BIR and the CTA in 2002 for the alleged erroneous payment of final withholding taxes.

The central issue in this case was whether VHL and WES each had established a permanent establishment in the Philippines pursuant to the Republic of the Philippines ("RP")-US and RP-UK Tax Treaties, respectively, and would thus be treated as resident foreign corporations subject to 5% creditable withholding tax. Applying the treaties, the CTA found that VHL and WES had established permanent establishments in the Philippines. However, a finding that they had effectively created permanent establishments does not automatically convert their status into "resident foreign corporations" in the Philippines. They still had to prove that they were resident foreign corporations; otherwise, they would be subject to final withholding tax of 32% of gross income as non-resident foreign corporations. The CTA held:

> [A] foreign corporation wishing to avail of the benefits of the tax treaty should invoke the provisions of the tax treaty and prove that indeed the provisions of the tax treaty applies to it, before the benefits may be extended to such corporation. In other words, a resident or non-resident foreign corporation shall be taxed according to the provisions of the National Internal Revenue Code, unless it is shown

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[13] Mirant (Philippines) Operations Corp. v. Comm'r of Internal Revenue, CTA-E.B. No. 40, Jun. 7, 2005 (Court of Tax Appeals).

> that the treaty provisions apply to the said corporation, and that, in case the same are applicable, the option to avail of the tax benefits under the tax treaty has been successfully invoked.
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> Under Revenue Memorandum Order 01-2000 of the Bureau of Internal Revenue, it is provided that *the availment of a tax treaty provision must be preceded by an application for a tax treaty relief with its International Tax Affairs Division (ITAD)*. This is to prevent any erroneous interpretation and/or application of the treaty provisions with which the Philippines is a signatory to. The implementation of the said Revenue Memorandum Order is in harmony with the objectives of the contracting state to ensure that the *granting of the benefits under the tax treaties are enjoyed by the persons or corporations duly entitled to the same.*
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> The Court notes that nowhere in the records of the case was it shown that petitioner indeed took the liberty of properly observing the provisions of the said order. Petitioner quotes various BIR, as well as ITAD, Rulings issued to several foreign corporations seeking for a tax relief from the office of the respondent. However, not any one of these rulings pertains to the petitioner. It must be stressed that BIR rulings are issued based on the facts and circumstances surrounding particular issue/issues in question and are resolved on a case-to-case basis. It would be thus erroneous to invoke the ruling of the respondent in specific cases, which have no bearing to the case of petitioner.[14]

Since Mirant did not observe the provisions of the RMO, the Court denied its claim for refund. Mirant appealed its case to the Supreme Court, which issued two minute resolutions: (1) denying to give due course to Mirant's petition,[15] and (2) denying with finality Mirant's motion for reconsideration.[16]

Under *Mirant,* the prior application to avail of tax treaty relief was mandatory. The taxpayer must secure an approved application and affirmative ruling from the BIR before it can avail itself of treaty benefits. Otherwise, it is disqualified from availing itself of tax treaty relief and barred from getting a refund for excess taxes paid, even if it is eventually shown that it is qualified under the treaty. This ruling has been reiterated in subsequent CTA decisions, the most notable of which are *Deutsche Bank AG Manila Branch v. Commissioner of Internal Revenue,*[17] where the CTA said that it has "consistently held that a ruling

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[14] *Id.* (Emphasis supplied.)

[15] Mirant (Philippines) Operations Corp. v. Comm'r of Internal Revenue, G.R. No. 168531, Nov. 12, 2007.

[16] Mirant (Philippines) Operations Corp. v. Comm'r of Internal Revenue, G.R. No. 168531, Feb. 18, 2008.

[17] CTA-E.B. Case No. 456, May 29, 2009 (Court of Tax Appeals).

from the International Tax Affairs Division (ITAD) of the BIR must be secured prior to availing a preferential tax rate under a tax treaty"; and *Commissioner of Internal Revenue v. CBK Power Company Ltd.*,[18] holding that "prior application filed with the BIR's ITAD is still required to avail of the provisions of tax treaties."

In 2010, the BIR released RMO No. 72-2010, which settled once and for all the issue of the mandatory filing of a prior TTRA. This RMO says that the taxpayer must file a TTRA before the occurrence of the first taxable event, i.e. "the first or the only time when the income payor is required to withhold the income tax thereon or should have withheld taxes thereon had the transaction been subjected to tax."[19] All TTRAs shall only be submitted to and received by the ITAD, otherwise they will be considered as improperly filed. Failure to file the TTRA before the transaction and with the ITAD shall disqualify the TTRA.[20] All rulings on TTRAs shall emanate from the ITAD.[21] Rulings must be available for release after 60 working days from the date of receipt of the TTRA or the date of receipt of complete documentary requirements by the ITAD, whichever comes later. For matters without income characterization, the ruling is released after 30 working days.[22]

The given objective of RMO No. 72-2010 is to streamline the processing of TTRA and to prescribe the documentary requirements of the TTRA to improve efficiency and service to the taxpayers.[23]

IV. CRITIQUE OF PRIOR TAX TREATY RELIEF APPLICATION AND RULING REQUIREMENT

A prior tax treaty relief application, *per se*, is not wrong (as a matter of policy), considering that its main purpose is to ensure that only those taxpayers who are entitled to tax treaty relief are the ones who can avail themselves of the same. As will be discussed later in this section, this purpose is consistent with the suggested method of the Organization for Economic Co-operation and Development (OECD) as regards prior verification of treaty entitlement. However, the manner in which the Philippines implements it does not advance

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[18] CTA-.E.B. Case No. 469, Mar. 29, 2010 (Court of Tax Appeals).

[19] Bureau of Internal Revenue Revenue Memo. Ordinance ("RMO") No. 72-2010, § 13 (2010), *available at* ftp:// ftp.bir.gov.ph/webadmin1/pdf/52924RMO%2072-2010.pdf (last visited Mar. 29, 2014). Guidelines on the Processing of Tax Treaty Relief Applications Pursuant to Existing Philippine Tax Treaties.

[20] § 14.

[21] § 15.

[22] § 15(i).

[23] § 1.

the objectives of the Philippines.

A. Defeats Taxpayer's Substantive Rights

As it now stands, all taxpayers with transactions relating to tax treaties need to get a ruling before getting tax treaty relief. The problem is that, although RMO No. 72-2010 provides that rulings are to be released within 30 to 60 working days from the time of filing of the TTRA or the complete submission of all documentary requirements, whichever comes later, taxpayers get their rulings after six months, at minimum, to more than one year, on average. Deutsche Bank AG Manila Branch, for example, in *Deutsche*,[24] filed with the ITAD as early as October 4, 2005 a request for confirmation that the remittance of branch profits to Deutsche Bank AG is subject to the preferential tax rate of 10% pursuant to Article 10 of the RP-Germany tax treaty.[25] As of the date of the decision on May 29, 2009, no ruling had been issued by the ITAD; this became the basis of the Court for denying Deutsche's claimed tax treaty benefits.[26]

This delay in the issuance of rulings is, in effect, defeating the substantive rights of taxpayers under the tax treaty. By not acting on the tax treaty relief application, the BIR is seemingly holding hostage the rights of the taxpayer. And by ruling that the actions of the BIR are valid, the courts are complicit in defeating the taxpayers' rights.

Time and again, the Philippine Supreme Court has ruled that rules of procedure and "technicalities should not be used to defeat substantive rights, especially those that have been proven as matters of fact."[27] When the CTA denied Mirant's claim for refund because it failed to file a TTRA even though the CTA established that WES and VHL have permanent establishments in the Philippines, it basically ruled that rules of procedure can trump substantive rights proven as facts.

In the very *apropos* case of *Casanova v. Commissioner of Internal Revenue*,[28] the US Tax Court ruled that a revenue procedure that requires a taxpayer to file forms prior to the time interest is paid to a foreign entity in order to claim treaty benefits is not permissible. It held:

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[24] C.T.A.-E.B. Case No. 456, May 29, 2009 (Court of Tax Appeals).

[25] *Id.*

[26] *Id.*

[27] Filinvest Development Corp. v. Comm'r of Internal Revenue, G.R. No. 146941, 529 SCRA 605, Aug. 9, 2007.

[28] 87 T.C. 214 (1986).

> In his cross-motion for summary judgment, however, respondent urges that both the Treasury Form 1001 and the Netherlands Antilles Form VS-4 must be filed with petitioner as withholding agent PRIOR TO THE TIME THE INTEREST IN QUESTION IS PAID. In support of this proposition, respondent relies upon Rev. Proc. 79-40, 1979-2 C.B. 504, which indeed purports to impose such requirements. Such revenue procedures, however, like revenue rulings, do not have the force of law and are merely statements of respondent's litigating and administrative position. We find nothing in the statute, the Convention, the Protocol or respondent's regulations which imposes such requirements, either specifically or under any reasonable exegesis of those provisions.
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> It can be urged, no doubt, that the requirements as to documentation and the timing thereof, as mandated by respondent in Rev. Proc. 79-40, are not unduly burdensome upon taxpayers, and are reasonable provisions to assure the orderly and efficient administration of the laws and the protection of the revenues. In the context of the present issue before the Court, however, *they go beyond this and have the effect of extending the law, and limiting the substantive rights of taxpayers, beyond that which the treaty provisions and respondent's regulations require.* This is not permissible. If respondent finds his existing regulation inadequate to carry out the administration of the Convention and the Protocol, *he may amend the regulation in a manner not inconsistent with the rights granted under the covenants between the two nations.* He may not do so by administrative fiat, nor should he expect this Court to do it for him.[29]

The Philippine Supreme Court has held that American jurisprudence has persuasive effect in the Philippines because Philippine income tax laws are of American origin.[30] Having said this, based on *Casanova*, revenue procedures that extend the law beyond what the treaty provisions require, and limit the substantive rights of taxpayers, should be struck down and held invalid. Note that the revenue procedure in *Casanova* merely required the prior filing of forms with the withholding agent; it did not require a favorable ruling from the IRS. This highlights how burdensome and inconsistent with treaty objectives the Philippines' prior TTRA and ruling requirement is.

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[29] *Id.* (Emphasis supplied.)

[30] Comm'r of Internal Revenue v. Solidbank Corp., G.R. No. 148191, 416 SCRA 436, Nov. 25, 2003; Chamber of Real Estate Builders' Associations, Inc. v. Romulo, G.R. No. 160756, 614 SCRA 605, Mar. 9, 2010.

B. Inconsistent with Philippine Tax Treaty Purpose

This mandatory procedure of claiming tax treaty relief and waiting for a ruling is a burden on the foreign entities claiming relief. In their desire to conclude their business transactions within their timeline, they sometimes opt not to avail themselves of the benefits under the relevant treaties just to avoid waiting for the go-signal of the BIR. This is a letdown to foreign investors who have decided to invest in the Philippines because of the promise of good tax incentives. Prospective foreign investors are then discouraged from investing in the Philippines. As a result, this mandatory process defeats the very purpose for which the Philippines enters into these tax treaties. As stated by the Supreme Court, "foreign investments will only thrive in a fairly predictable and reasonable international investment climate."[31] The whole process of filing a prior TTRA and getting a ruling makes the Philippine investment climate unpredictable and unreasonable to foreign investors.

The CTA itself, in another decision, ruled that excessive administrative requirements should not be a reason to deter the purposes of a treaty. It stated:

> *It is not for the respondent to impose administrative interference particularly where treaty commitments between signatory states are involved.* Compliance by the other state to its treaty commitment is entitled to as much deference as the compliance by the Philippines. Nowhere is it reflected in the provisions of the subject tax treaty that taxes need be paid by the resident of the other contracting state in said state before tax spareness as promised therein can be claimed. [...] In tax treaties between states used to avoid double taxation, the commitment by the parties mainly involved the allowance of a matching credit or tax relief, or reciprocal actions. The conclusion and ratification of the tax treaty is enough to leave an assurance to the parties that the commitment will be honored. *The creation of administrative requirements that will not facilitate transactions but instead make for excessive routines will defeat another purpose of tax treaties which is the improvement of commerce.*[32]

Barring RMO No. 72-2010, what is stopping a taxpayer from claiming the tax treaty relief based on his own understanding of the tax treaty by just filing a TTRA and return with the BIR and informing it that it intends to avail itself of the tax treaty benefits, without the need to wait for the go-signal of the BIR? What is stopping the BIR from assessing the taxpayer for additional taxes,

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[31] Comm'r of Internal Revenue v. S.C. Johnson & Son, Inc., G.R. No. 127105, 309 SCRA 87, Jun. 25, 1999.

[32] Phil. Long Distance Telephone Co. v. Comm'r of Internal Revenue, CTA Case No. 4375, Jan. 7, 1992 (Court of Tax Appeals). (Emphasis supplied.)

interest, and penalties, if the BIR later finds that the taxpayer is wrong in claiming the treaty benefits? Is the "evil sought to be avoided" by the issuance of the said RMO "greater than the one done to avoid it?" Is there "no other practical and less harmful means of preventing it?"[33]

C. Inconsistent with Tax Treaty Obligation

Administrative orders and "issuances have the force and effect of laws. They benefit from the same presumption of validity and constitutionality enjoyed by statues."[34] In fact, the CTA, in *CBK Power*, said that, RMO No. 1-2000, as amended by RMO No. 72-2010, has the force and effect of law.[35] As discussed earlier, the burdensome nature of this administrative order is inconsistent with the purpose of the tax treaties and amends and/or defeats the substantive rights of the taxpayers in tax treaties. Its implications and effects, therefore, can be compared to tax treaty overrides.

A treaty override, as defined in the 1989 OECD Treaty Override Report, is "where the domestic legislation of a State overrules treaty provisions of either a single treaty or all treaties hitherto having had effect in that State."[36] It can be intentional or unintentional. Examples of the latter are: (1) when a decision of the court is contrary to the known interpretation of the treaty; (2) when the state provides a definition for an undefined treaty term that has the effect of contradicting the treaty; or (3) when the state inadvertently legislates a domestic law overriding the treaty.[37]

The constitutional provisions of each state on the interaction of international treaty obligations law and domestic law will determine whether a treaty override is unconstitutional or not, and thus whether it should be given primacy over a treaty obligation.[38] Nonetheless, under the principle of *pacta sunt servanda*, contracting states are bound to apply treaty provisions in good faith. Further, under Article 27 of the VCLT, contracting states may not use their domestic laws to justify nonperformance of a treaty obligation. Thus, the OECD

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[33] Borrowing the words of the Supreme Court in *Ty v. People*, G.R. No. 149275, 439 SCRA 220, 232, Sep. 27, 2004, *citing* REV. PEN. CODE, art. 11(4).

[34] James Mirasol v. Dep't of Public Works & Highways, G.R. No. 158793, 490 SCRA 318, Jun. 8, 2006, *citing* Eslao v. Commission on Audit, G.R. No. 108310, Sep. 1, 1994.

[35] Comm'r of Internal Revenue v. CBK Power Co. Ltd., CTA-.E.B. Case No. 469, Mar. 29, 2010 (Court of Tax Appeals).

[36] ROHATGI, *supra* note 4, at 34.

[37] *Id.*

[38] *Id., citing* 1989 OECD Treaty Override Report, ¶ 14.

considers a treaty override as a breach of a treaty and illegal under international law.[39]

In the international tax community, tax treaty overrides have been questioned and criticized as breaches of obligations under international law and with treaty partners,[40] although often justified as merely interpretative of existing tax treaty provisions and are consistent with them.[41] In the US, for example, the enactment of § 6038(A), which provides for reporting requirements of foreign-controlled corporations, had to be justified as non-discriminatory and not in violation of existing treaty obligations.[42]

It has been said that tax treaty overrides harm a contracting state in various ways. Overrides violate international law, which cause damage to the international legal order and the reputation of the contracting state in the international community, They destroy the trust of the treaty partners in the contracting state. And, since treaty partners may want to retaliate on the override, it becomes more difficult for the citizens and residents of the contracting state to avail themselves of treaty benefits and for the government to negotiate reciprocal concessions.[43]

Like tax treaty overrides, the prior TTRA and ruling requirements under RMO No. 72-2010 are subsequent administrative requirements having the effect of law, which result in overriding the Philippines' tax treaty obligations and commitments since they hinder the right of the residents of the other contracting state to avail themselves of tax treaty benefits. As such, the prior TTRA and ruling requirements harm the Philippines in the following ways:

1. RMO No. 72-2010 Violates International Law

While RMO No. 72-2010 and its prior versions are valid under Philippine law and adhered to by the courts in their decisions as regards taxpayer claims for treaty benefits, its onerous and burdensome nature results in the failure of the Philippines to adhere to its treaty commitments. It is contrary to the fundamental principle of *pacta sunt servanda* that the Philippines subsequently places hurdles against residents of contracting states who seek to claim tax treaty relief when such were not contemplated at the time of the negotiation of the

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[39] ROHATGI, *supra* note 4, at 34-36.

[40] Anthony Infanti, *Curtailing Tax Treaty Overrides: A Call to Action*, 62 U. PITT. L. REV. 677 (2001).

[41] David Raish & Susan Stone, *Issues Paper on the Tax Treaty Making Process*, 46 TAX LAW. 477, 498 (1993); ROHATGI, *supra* note 4, at 35.

[42] Raish & Stone, *supra* note 41, at 497.

[43] Infanti, *supra* note 40, at 687-688.

treaty and were not incorporated in the treaty itself.

The lack of good faith is more glaring since the other contracting states to Philippine treaties do not require the same procedure for Philippine citizens and residents for the availment of tax treaty relief. For example, in the US, a taxpayer has to disclose his tax treaty-based position by filing Form 8883 under § 6114 of the US Internal Revenue Code. However, filing Form 8883 is not a condition *sine qua non* for the application of treaty benefits. The failure to do so only entails a monetary penalty and does not deny the taxpayer of his rights under the tax treaty.[44]

Thus, RMO No. 72-2010 is a source of breach of the tax treaty and a violation of public international law. It cannot be justified under public international law.[45]

2. RMO No. 72-2010 Hurts the Philippine Economy

As discussed earlier, the prior TTRA and ruling requirements sometimes result in residents of contracting states losing treaty benefits to which they are entitled. As a result, foreign investors will prefer to go to other countries (like the Philippines' neighbors in Asia) rather than invest in the Philippines, a country known to have a policy that allows it to breach its tax treaty obligations. This breach harms both the economy of the Philippines and "the international economy in general because of the increasing uncertainty of tax consequences of investments in foreign countries."[46]

3. RMO 72-2010 Damages the Reputation of the Philippines in the International Community and Destroys the Trust of Treaty Partners

The hurdles to getting tax treaty relief placed by the Philippines create the impression that the Philippines does not want to fulfill its obligation under the tax treaty. It gives the Philippines a reputation of a country that reneges on its promises, and thus puts into question its integrity in the international community. Doubts will arise as to whether the Philippines will assume its

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[44] Patrick Martin & Pedro Corona de la Fuente, *U.S. Tax Treaties and Section 6114: Why a Taxpayer's Failure to "Take" a Treaty Position Does Not Deny Treaty Benefit, at* http://www.procopio.com/news/u.s.-tax-treaties-and-section-6114-why-a-taxpayers-failure-to-take-a-treaty-position-does-not-deny-treaty-benefits (last visited Mar. 30, 2013).

[45] *See* Helmut Becker & Felix Würm, *Double-taxation conventions and the conflict between international agreements and subsequent domestic laws*, 8-9 INTERTAX 261 (1988). In their article, Becker and Würm discuss the pitfalls of the enactment by a state of a domestic law that conflicts with a treaty.

[46] *Id.* at 262.

obligations in other treaties it has entered and will enter into with other countries. Over time, it might be difficult for the Philippines to negotiate new treaties with other countries. Questions may arise as to whether the other contracting state can reach an effective and lasting treaty with the Philippines, given that the Philippines has already breached another treaty.[47]

Aside from the damage to its reputation, the Philippines should be worried that other contracting states will retaliate by placing obstacles for Philippine citizens and residents in their availment of treaty benefits. They can even go further by terminating their treaties with the Philippines.

D. Source of Corruption

Most taxpayers view the prior TTRA and ruling requirements as another avenue for corruption in the BIR, which is known to be one of the most corrupt government agencies in the Philippines.[48] In their quest to get a favorable ruling in the shortest time possible, it is not uncommon for taxpayers, whether local or foreign, to "gift" a BIR official with huge amounts of cash and luxury goods. Even if not assured of a favorable ruling, a taxpayer might pay money just to hasten the release of the decision. Given that there is realistically no set time frame for the release of rulings, BIR officials effectively hold the transaction hostage, and are seemingly waiting for "something" from the taxpayer so that they will start acting on the request for ruling. This process and all of its entailed delays may be said to encourage bribery in the service.

A Filipino opinion writer said in his newspaper column that people are reluctant to pay taxes to the government because they believe that it will just go to corrupt officials anyway. People believe that the BIR is always short of its collection target because the BIR system is inefficient and its officials are corrupt. Around 20 percent of the national budget or about PHP 250 billion per year is lost due to corruption. Even the current Commissioner of Internal Revenue admits that corruption in the BIR will remain after she has gone, although she is currently implementing programs to fight this problem.[49]

Corruption is one of the most talked about issues in the world as it is a

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[47] *Id.* at 262-263.

[48] *See* Tabunda, *supra* note 1.

[49] Babes Romualdez, *Babe's Eye View: BIR- Feared, hated or loved,*, The Phil. Star, Dec. 9, 2012, *available at* http://www.philstar.com/opinion/2012-12-09/883749/bir-feared-hated-or-loved (last visited Mar. 29, 2014). *See* Iris C. Gonzales, *Reforming the BIR: Dream or Reality?*, Sept. 8, 2010, *at* http://www.transparencyreporting.net/index.php?option=com_content&view=article&id=125:reforming-the-bir-dream-or-reality-&catid=44:stories&Itemid=94 (last visited Mar. 29, 2014).

very serious problem that affects all areas of society. It undermines the economic development of a country specifically as foreign investors shy away from countries that practice rampant corruption. They consider these countries as fostering an unstable environment for business.

Even if the Philippines today is considered an exciting market,[50] investors will hesitate to invest in the country if they feel that their business will just be hampered by corruption. Given that possible investors perceive the ruling process for tax treaty relief as mired in corruption, they will prefer to go to other treaty countries where such rulings are unnecessary to claim their tax treaty benefits. The prior TTRA and ruling procedure deters the Philippines from meeting its goal of attracting foreign investment and improving its economy.

E. Inconsistent with OECD Commentaries

Although tax treaties do not provide for the procedure on how residents of contracting states can avail themselves of treaty benefits, the OECD Commentaries provide guidelines on how states should address the procedural aspects for the limits on source taxation. The OECD included the following in 2003:

> A number of Articles of the Convention limit the right of a State to tax income derived from its territory. [...] [T]he Convention does not settle procedural questions and each State is free to use the procedure provided in its domestic law in order to apply the limits provided by the Convention. A State can therefore automatically limit the tax that it levies in accordance with the relevant provisions of the Convention, *subject to possible prior verification of treaty entitlement*, or it can impose the tax provided for under its domestic law and subsequently refund the part of that tax that exceeds the amount that it can levy under the provisions of the Convention. As a general rule, *in order to ensure expeditious implementation of taxpayers' benefits under a treaty*, the first approach is the highly preferable method. If a refund system is needed, it should be based on observable difficulties in identifying entitlement to treaty benefits. Also, where the second approach is adopted, it is extremely important that the refund be made expeditiously, especially if no interest is paid on the amount of the refund, as any undue delay in making that refund is a direct cost to the

[50] *See* Tarra Quismundo, *UK 'excited' over trade with the Philippines*, Phil. Daily Inquirer, Nov. 12, 2012, *available at* http://business.inquirer.net/92398/uk-paints-bright-outlook-on-trade-with-philippines.

taxpayer.[51]

Thus, when countries provide for their own procedures on how taxpayers can claim treaty benefits, they should not forget that the underlying objective for these procedures is the "expeditious implementation of taxpayers' benefit under a treaty."[52]

The OECD advises member states to use the interpretations provided in OECD Commentaries in applying their tax treaties. Although not binding as international law, the Commentaries are given much value by member states. The Commentaries provide interpretations of treaty provisions that are in compliance with the OECD Model Convention that must be assumed in good faith. They serve as guides to US courts and the US Internal Revenue Service (IRS) in the interpretation of tax treaties.[53]

Although the Philippines is not a member state of the OECD, many of its tax treaties are based on the OECD Model Convention.[54] Hence, it is prudent to follow the interpretations of the OECD Commentaries in interpreting and applying the tax treaties of the Philippines with other countries.

Two procedures are mentioned—though not imposed—by the OECD Commentaries: (1) prior verification of treaty entitlement, and (2) a refund system. The former is the preferred method because it ensures "expeditious implementation of taxpayers' benefits under a treaty."[55] The current procedures of the Philippines are clearly inconsistent with the procedures given by the OECD.

The Philippines requires prior verification of treaty entitlement through the mandatory filing of a TTRA under RMO 72-2010. The purpose stated in the earlier RMO 1-2000—to avoid the wrongful interpretation of tax treaty provisions before pursuing the transaction and/or paying any taxes—is consistent with the OECD prior verification. However, the current procedure and implementation of the same do not meet the OECD objective of ensuring that taxpayers can promptly avail themselves of treaty benefits. Instead, as

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[51] COMMENTARIES ON THE ARTICLES OF THE MODEL TAX CONVENTION, art. 1, ¶ 26.2, *available at* http://www.oecd.org/berlin/publikationen/43324465.pdf (last visited Mar. 29, 2014), *cited in* Martin & Corona, *supra* note 44. (Emphasis supplied.)

[52] Martin & Corona, *supra* note 44.

[53] René Matteotti, *Interpretation of Tax Treaties and Domestic General Anti-Avoidance Rules - A Sceptical Look at the 2003 Update to the OECD Commentary*, 33 INTERTAX 339 (2005).

[54] VICTORINO C. MAMALATEO et al., TAXATION OF BUSINESS PROFITS UNDER THE PHILIPPINE TAX CODE AND TAX TREATIES 14 (2005).

[55] Martin & Corona, *supra* note 44. (Citations omitted.)

discussed above, the prior TTRA and ruling procedure is a source of red tape that frustrates the objectives of tax treaty benefits.

As regards the OECD refund system, the taxpayer pays the taxes first according to the local law then gets a refund of any excess in accordance with the treaty. It prescribes that the refund be made expeditiously especially if no interest is to be paid on the amount of the refund. Even though the Philippines has a procedure for claims for refund in its tax code,[56] it does not follow the refund system provided in the OECD Commentaries. As held in *Mirant,* in order to claim a refund, the taxpayer must have filed a prior TTRA with the ITAD. The Philippine refund system as regards tax treaties is combined with the prior TTRA and ruling procedure. The BIR and the courts do not take into account, however, that the reason why a taxpayer may be claiming a tax refund in the first place is that it paid higher taxes because it mistakenly found a tax treaty inapplicable to its circumstances. Therefore, it could not have filed a tax treaty relief application before the subject transaction. Had it known of the applicability of a tax treaty from the beginning, the taxpayer would have readily availed itself of the benefits of the same, and there would have been no need to claim a refund.

It should be noted that the CTA previously ruled in *Jardine Davies Insurance Brokers, Inc. v. Commissioner of Internal Revenue*[57] that the incomplete submission of documents to process an application for tax treaty relief is not a "condition *sine qua non* for the entitlement to the refund being claimed." This case involved RMO No. 10-92, which preceded RMO No. 1-2000. The CTA held:

> We do not agree with respondent's contention that the submission of all documents mentioned in RMO 10-92 is essential to the grant of the claim for refund or tax credit. *As correctly put by the petitioners, the documentary requirements provided in RMO No. 10-92 were meant to facilitate the processing of application for tax refund/credit involving the availment of the tax treaty rate. For this Court's purposes, the complete submission of said documents is not a condition* sine qua nn *for the entitlement to the refund being claimed.*
>
> *When petitioner filed an appeal with this Court, it transformed the administrative claim for refund into a judicial claim for refund, because an appeal to the Court of Tax Appeals is manifestly judicial.*[58]

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[56] *See* TAX CODE, §§ 204, 209.
[57] CTA Case No. 5140, Mar. 19, 1997 (Court of Tax Appeals).
[58] *Id.* (Emphasis supplied; citations omitted.)

In granting the claim for refund, the CTA, after determining that the refund provisions of the Tax Code were complied with by the petitioner, applied the provisions of the RP-Netherlands Tax Treaty and found "the evidence presented by petitioners sufficient to prove its entitlement to the refund or tax credit being claimed."

V. FRAMEWORK FOR TAX TREATY IMPLEMENTATION

Given the foregoing discussion, and in order to align the objectives of all stakeholders, the BIR should reevaluate the manner in which it is implementing the prior TTRA and issuance of ruling requirements. A better mechanism and procedure would assure a taxpayer who is qualified under a tax treaty of getting the benefits of the treaty in the most expeditious manner.

The UN Model Tax Treaty Commentary advises that, in developing their own procedural provisions regarding treaty obligations and treaty application, developing countries may learn "from countries that have successful experience of treaty application."[59]

In this regard, the Philippines may look at the tax procedures of developed countries on the application of tax treaties. In particular, it may be wise to examine the US tax procedures, considering that that the US has one of the biggest economies and has a lot of cross-border transactions with countries all over the world. The US is also one of the largest foreign investors in the Philippines, committing to at least PHP 8.9 billion in foreign direct investments as of the third quarter of 2012.[60] In addition, the Philippines may learn from evaluating the tax rulings system of the US—one of the world's most advanced, and developed to help taxpayers wade their way through the US's very complex and technical tax laws.[61]

First, the BIR should consider following the procedure of the US under § 6114 of the US Internal Revenue Code, which merely requires the taxpayer to declare its tax treaty position by submitting the appropriate form and documents with the return to claim applicable tax treaty benefits. The taxpayer should not

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[59] COMMENTARIES ON THE ARTICLES OF THE UNITED NATIONS MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED & DEVELOPING COUNTRIES, art. 1, ¶ 100 (2011) *at* http://www.un.org/esa/ffd/ documents/UN_Model_2011_Update.pdf (last visited Mar. 29, 2014).

[60] *FDI Quarterly Report, 3rd Quarter 2012*, Jan. 28, 2013, *at* http://www.nscb.gov.ph/fiis/ 2012/3q_12/Default.asp (last visited Mar. 29, 2014).

[61] CARLO ROMANO, ADVANCE TAX RULINGS AND PRINCIPLES OF LAW: TOWARDS A EUROPEAN TAX RULINGS SYSTEMS? xii (2002).

have to wait for BIR approval or a ruling to claim tax treaty benefits. Non-filing of the form should not entail the denial of the benefits of the treaty, but only payment of penalty. The transaction should be subject to audit by the BIR, and the taxpayer could be assessed for additional taxes, interests, and penalties should the BIR find that the transaction did not actually merit tax treaty relief.

This procedure for claiming tax treaty relief will support the self-assessment system in the Philippines, in which the taxpayer is responsible for determining the tax consequences of his transaction, filing the necessary returns and documents, and paying any taxes due.[62] More importantly, this procedure will free up the resources of the BIR and give the taxpayer immediate tax treaty relief. Furthermore, the BIR may still collect the taxes properly due to the government by way of the mechanisms of audit and assessment.

Second, if the BIR insists on requiring a prior TTRA and ruling before a taxpayer can avail itself of benefits under the treaty, it should separate the effects of the non-filing of the TTRA on the initial claim for benefits from the claim for refund of excess taxes paid. A taxpayer who failed to file a TTRA and secure a ruling should not be precluded from getting a refund of excess taxes paid, provided it is able to prove to the BIR and/or to the courts that the tax treaty provisions were applicable to the circumstances. The BIR should take into account that the taxpayer mistakenly thought that the tax treaty was not applicable and, therefore, could not have filed a TTRA before the transaction. Further, the process of availing oneself of tax treaty relief should be separated from the process of filing a claim for refund.

Third, the BIR should develop a list of no-ruling areas relating to issues on cross-border transactions and tax treaties. This way, the taxpayer would not need to file a request for a ruling for any and all transactions and issues that involve tax treaties. This would save the time and the resources of both the BIR and the taxpayer.

Neither RMO No. 1-2000 nor RMO No. 72-2010 provides for the transactions and issues for which the ruling requirement will be waived. Except for instances where the taxpayer or its representative fail to submit complete documentation, the BIR must rule on all TTRAs.[63] Even transactions that have no issues on income characterization require the filing of a TTRA and the issuance of ruling.[64] In 2003, after the issuance of RMO No. 1-2000, the BIR released Revenue Bulletin No. 01-2003, which lays out the procedure on the

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[62] *Id.* at 427.
[63] Bureau of Internal Revenue RMO No. 72-2010, § 16 (2010).
[64] § 15(i).

handling of requests for ruling that are determined as "No-Ruling Areas," and provides the initial list of "No-Ruling Areas." Although it states that the ruling function need not be exercised where the law, rule, or regulation is clear, it limits the no-ruling areas to the list in the bulletin. None of the transactions and issues in the list pertain to international tax transactions or any matters involving tax treaties.

Looking at the US tax system on this matter, the IRS releases a Revenue Procedure every year that contains a list of no-ruling issues under the jurisdiction of its Associate Chief Counsel (International). This list serves to alert taxpayers and practitioners of topics that will not be ruled upon by the IRS because they involve mainly factual questions.[65] Examples of no-ruling treaty issues under Revenue Procedure 2013-7[66] are:

1. Whether a person who is a resident of a foreign country and derives income from the US is entitled to benefits under the US income tax treaty with that foreign country pursuant to the limitation on benefits article;[67]

2. Any area where the same issue is the subject of the taxpayer's pending request for competent authority assistance under a US tax treaty;[68]

3. An issue that is clearly and adequately addressed by statute, regulations, decisions of a court, tax treaties, revenue rulings, or revenue procedures, for which a "comfort" ruling will not be issued absent extraordinary circumstances;[69]

4. Whether the income received by an individual in respect of services rendered to a foreign government or a political subdivision or a local authority thereof is exempt from federal income tax or withholding under any of the US income tax treaties which contain provisions applicable to such individuals;[70]

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[65] II PHILIP FREDERICK POSTLEWAITE, INTERNATIONAL TAXATION: CORPORATE AND INDIVIDUAL xxxiii (5th ed. 2010).

[66] Rev. Proc. 2013-7, I.R.B. 2013-1, 233 (2013).

[67] § 3.01(4). However, the IRS may rule regarding the legal interpretation of a particular provision within the relevant limitation on benefits article. *Id.*

[68] § 3.02(5).

[69] § 3.02(6).

[70] § 4.01(9).

5. Whether a taxpayer has a permanent establishment in the US for purposes of any US income tax treaty and whether income is attributable to a permanent establishment in the US;[71]

6. Whether certain persons will be considered liable to tax under the laws of a foreign country for purposes of determining if such persons are residents within the meaning of any US income tax treaty;[72]

7. Whether the income received by a nonresident alien student or trainee for services performed for a university or other educational institution is exempt from federal income tax or withholding under any of the US income tax treaties which contain provisions applicable to such nonresident alien students or trainees;[73]

8. Whether the income received by a nonresident alien performing research or teaching as personal services for a university, hospital or other research institution is exempt from federal income tax or withholding under any of the US income tax treaties which contain provisions applicable to such nonresident alien teachers or researchers;[74]

9. Whether a foreign recipient of payments made by a US person is ineligible to receive the benefits of a US tax treaty;[75]

10. Whether a recipient of payments is or has been a resident of a country for purposes of any US tax treaty;[76]

11. Whether an entity is treated as fiscally transparent by a foreign jurisdiction for purposes of § 894(c) and the regulations thereunder;[77] and

12. Any transaction or series of transactions that is designed to achieve a different tax consequence or classification under US

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[71] § 4.01(10).
[72] § 4.01(11).
[73] § 4.01(12).
[74] § 4.01(13)
[75] § 4.01(14)
[76] § 4.01(15). The IRS may rule whether a corporation representing that it is a resident of a country is a qualified resident thereof for purposes of 26 USCA § 884.
[77] § 4.01(16).

tax law (including tax treaties) and the tax law of a foreign country, where the results of that different tax consequence or classification are inconsistent with the purposes of US tax law (including tax treaties).[78]

The above issues may be considered by the BIR in developing No-Ruling areas specifically for tax treaties and cross-border transactions. It must be noted, though, that the US tax system is so much more complex and advanced than the Philippines. Further, the National Internal Revenue Code of the Philippines generally does not include provisions on international taxation and cross-border transactions.

A possible start on issues, matters, and transactions—since the BIR requires that all transactions obtain a tax ruling—that do not need the issuance of ruling by the BIR, unless there is really a difficult question of law and compelling reason for the BIR to rule on the matter, are:

1. Issues that are clearly and adequately addressed by tax treaties;
2. Established and recurring payments of dividends distributed by Filipino companies to non-residents, especially if a Filipino company's stocks are being traded in the stock exchange;[79]
3. Whether a taxpayer has a permanent establishment in the Philippines and income can be attributed to the Philippine permanent establishment;[80]
4. Established and recurring payment of royalties and interests on loans;[81] and
5. Transactions where there is no question on income characterization.

On the other hand, issues that may necessitate a ruling are: (1) one-time transactions, e.g. whether the sale of Philippine shares by a nonresident done outside the stock exchange is subject to capital gains tax or not; and (2)

[78] § 4.02(3).

[79] E-mail from Charito R. Villena, Esq., CPA, a tax counsel of Philippine Long Distance Co, (Mar. 13, 2013, 10:26:42 PM EDT) (on file with author); e-mail from Cherry Vi Saldua, Esq., CPA, tax practitioner in the Philippines (Mar. 13, 2013 10:10:21 PM EDT) (on file with author).

[80] Villena, *supra* note 79.

[81] *Id.*

confusion as to income characterization, e.g. royalty versus business profits.[82]

If the BIR will not issue rulings on the above matters, then there will be no need for the taxpayer to request for a ruling submitting a claim for tax treaty relief. This will ensure that the taxpayer can expeditiously claim the tax treaty benefit. This will also free up the BIR's time and other resources.

Fourth, and most importantly, the BIR must ensure that it consistently releases its rulings within the time frame stated in RMO No. 72-2010, i.e. after 60 working days from the date of receipt of the TTRA or the date of receipt of complete documentary requirements by the ITAD, whichever comes later, or after 30 working days for matters without income characterization. It will be better if it can release the rulings earlier than 60 or 30 days so as to ensure that taxpayers can get immediate benefits under the tax treaty. Furthermore, it will remove, or at least lessen, the taint of corruption in the BIR. Taxpayers will not think that they have to bribe the officers of the BIR in order to get a ruling because they will be assured that they will get it after 60 days, at the latest. This will give reliability and credibility to tax administration in the Philippines.

When the system has been fixed, and there is reliability in the issuance of rulings by the BIR, the BIR might consider the viability of issuing advance tax rulings, especially on issues concerning cross-border transactions and tax treaties.

Currently, the BIR requires that all requests for rulings be on consummated transactions with the submission of all the necessary documents. One of the no-ruling areas is on issues based on hypothetical transactions.[83] Hypothetical transactions, though used in the sense of theoretical and imagined facts and circumstances,[84] include proposed and future transactions. The difference is that proposed transactions are contemplated future transactions with a series of specified facts.[85] Probably, the main reason behind this is that the BIR wants to give priority to actual transactions where taxpayers want to know what their immediate tax liabilities are.[86]

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[82] *Id.*

[83] Bureau of Internal Revenue Rev. Bul. No. 01-2003, § 2(t) (2003).

[84] ROMANO, *supra* note 61 at 213.

[85] *Id.* at 108.

[86] *See* ROMANO, *supra* note 61, at 14, *citing* Commissioner's Mimeographed Published Opinion 2228, 1 C.B. 310 (1919), *quoted in* D.E. Osteen, L.J. Jones & H.S. Fischer, *The Private Letter Ruling Program at Half Century Mark*, 42 U.S.C. LAW CENTER TAX INST. 12-1 at 1205 (1990).

This limitation does not help taxpayers plan their transactions given the often "problematic application and interpretation of tax law provisions."[87] The tax imposed on a transaction is one of the major considerations of any taxpayer; it will be advantageous to have some certainty on its tax consequences before proceeding with it. Indeed, the need for certainty in the taxability of cross-border transactions and the effect of applicable tax treaties make the limitation of rulings on completed transactions more difficult. Foreign investors will only decide to invest in a particular country like the Philippines after much tax-planning. It will be helpful if they can know in advance from the BIR the tax consequence of their transactions.

The International Fiscal Association defined advance tax rulings as a "more or less binding statement from the Revenue authorities upon the voluntary request of a private person, concerning the treatment and consequences of one or a series of contemplated future actions or transactions."[88] Advance tax rulings have been said to be "an indispensable tool in the modern world of tax administration."[89] In order for this system to be effective and have a significant contribution to tax administration, the advance tax ruling must have a binding effect on the tax authorities, but only if the factual circumstances and issues submitted in the request for ruling are consistent with the consummated transaction.[90] However, the requesting taxpayer alone may rely upon advance tax rulings.[91] In most jurisdictions, the taxpayer who requests for a ruling is required to pay a fee usually based on the amount of time spent by the ruling authority in drafting the ruling.[92] Payment of fees may be used to curb requests for comfort rulings or "rulings on frivolous and vexatious issues."[93] It is also important that only a short period of time elapses between the request for ruling and the issuance of the ruling as most transactions are under time constraints and to avoid the possibility of change in facts of the transaction or change in the applicable law.[94]

The US tax system has advance tax rulings in the form of letter rulings, which, according to Revenue Procedure 2013-7,[95] are "written determination[s] issued to a taxpayer [...] in response to the taxpayer's written inquiry, filed prior

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[87] ROMANO, *supra* note 61, at 417.

[88] M. Ellis, General Report, *Advance Rulings*, LXXXIVb IFA CAHIERS DE DROIT FISCAL INTERNATIONAL 22 (1999), *cited in* ROMANO, *supra* note 61, at 119.

[89] This is the wording used by M. Ellis, *supra* note 88.

[90] ROMANO, *supra* note 61, at 255-257.

[91] *Id.* at 268.

[92] *Id.* at 277.

[93] *Id.*

[94] *Id.* at 248.

[95] Rev. Proc. 2013-1, I.R.B. 2013-1 (2013).

to the filing of returns or reports that are required by the tax laws, about its status for tax purposes or the tax effects of its acts or transactions. A letter ruling interprets the tax laws and applies them to the taxpayer's specific set of facts."[96] The IRS issues a letter ruling on both proposed and completed transactions, as long as the taxpayer submits the request before the necessary return is filed.[97] There is a list of matters though that the IRS will not issue rulings on.[98] A letter ruling may be relied on by the requesting taxpayer alone and has a binding effect on the IRS, as long as there have been no changes in the law, and the controlling facts on which the letter ruling is based are consistent with those in the actual transaction.[99] The IRS charges a user fee for the issuance of letter rulings, with a request on the issue of tax treaty limitation of benefits going for a fee of USD 27,500.00[100] The IRS does not prescribe a specific time by which the ruling will be issued. Nonetheless, within 21 calendar days from the receipt of the request for ruling, a representative of the IRS will call the taxpayer to discuss the procedural issue and tell the taxpayer whether it will rule as the taxpayer requested, rule adversely on the matter, or not rule at all, as well as whether or not the taxpayer needs to submit additional information.[101] The taxpayer can request for expeditious handling, but whether it will be granted will depend on the discretion of the IRS.[102]

The BIR, in developing an advance tax ruling system will have to consider the foregoing factors, i.e. the scope of the advance tax rulings, their binding effect, the timing of their issuance, and the applicable fees for their issuance. What is important is that this advance ruling can be used by the taxpayer to avail himself of the benefits of the tax treaty without the need for getting another ruling from the BIR after the transaction is consummated. Of course, the controlling facts in the ruling should be the same as in the completed transaction for the ruling to be binding on the BIR.

Admittedly, this advance tax ruling system will only work if the tax authorities and the tax administration are credible and reliable. The BIR officials deciding on the issues must be knowledgeable of the intricacies of tax laws and treaties. The timing for the release of rulings must be consistent and prompt. Unless these factors are present, this system will only be a source of delay for taxpayer relief and corruption in the service.

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[96] § 2.01.
[97] *Id.* at ¶ 1.
[98] *Id.* at § 6.
[99] *Id.* at § 11.
[100] *Id.* at Appendix A.
[101] *Id.* at § 8.02.
[102] *Id.* at § 7.02(4).

VI. CONCLUSION

With the ongoing trend of globalization, the Philippine economy will continue to grow if it provides an attractive and reliable investment climate for foreign investors. These investors, who have multiple options as to countries to invest in, take into account the certainty of the tax consequences of their business transactions. The consistency of the application of tax treaties by the Philippines can help ensure this.

We have seen, however, that the current system of the Philippines on claiming tax treaty benefits does not meet this objective. In fact, the requirements of a prior tax treaty relief application and ruling under RMO No. 72-2010 defeat the taxpayer's substantive rights, are inconsistent with the purpose for which the Philippines enters into tax treaties and with international norms and obligations, and are a source of corruption.

To this end, it is the right time for the BIR to evaluate the prior tax treaty relief application and ruling requirements. A prior tax treaty application *per se* is acceptable as long as it meets the objective of properly screening taxpayers who have the right to avail themselves of tax treaty benefits and, at the same time, expeditiously granting them those benefits. The BIR may examine the feasibility of applying the system of the US where taxpayers, to avail themselves of tax treaty benefits, need only take a tax treaty position by filing the appropriate form with the return. The BIR must amend the current system to ensure that a taxpayer who failed to avail itself of treaty benefits, should still be entitled to a refund of excess taxes as long as it is able to prove the applicability of tax treaty provision to its circumstances, notwithstanding its failure to file the prior application for tax treaty relief. The BIR should develop a list of no-ruling issues relating to cross-border transactions and tax treaties to save the time and the resources of both the BIR and the taxpayer. Lastly, the BIR must ensure that it consistently releases its rulings within the timeframe stated in the RMO.

Careful analysis of the current system of implementing tax treaties must be done in order to uphold and promote the interest of the Philippines. The BIR must consider the fact that its procedures reflect on the Philippines and the government's reputation and integrity, both domestically and internationally, such that it must create measures that will improve the reliability and credibility of its service.

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