

### Title: Commissioner of Internal Revenue v. Smart Communications, Inc.

### Facts:

Smart Communications, Inc. (Smart), a Philippine corporation registered with the Board of Investments, entered into agreements with Prism Transactive (M) Sdn. Bhd. (Prism), a Malaysian company, for programming and consultancy services in 2001. Smart billed Prism US\$547,822.45 for these services, which Smart thought constituted royalties subject to a 25% royalty tax under the RP-Malaysia Tax Treaty. Smart then withheld and remitted to the Bureau of Internal Revenue (BIR) P7,008,840.43.

On September 24, 2003, Smart filed an administrative claim for a refund with the BIR, arguing that the payments were not royalties but “business profits,” and therefore not taxable under the RP-Malaysia Tax Treaty. The Commissioner of Internal Revenue (CIR) did not act on the claim, prompting Smart to file a Petition for Review with the Court of Tax Appeals (CTA) Second Division.

The CTA Second Division granted Smart a partial refund, and both parties sought reconsideration, which was denied. Both parties appealed to the CTA En Banc, which affirmed the partial refund. The CIR, dissatisfied, sought reconsideration, which was denied.

### Issues:

1. Whether Smart, as a withholding agent, had the right to file the claim for refund.
2. If Smart had the right, whether the payments made to Prism constituted “business profits” or royalties.

### Court’s Decision:

The Supreme Court denied the petition, affirming Smart’s right to file for a refund and the distinction between payments for royalties and business profits.

1. **\*\*Right to File the Claim for Refund\*\***: The Court clarified that a withholding agent, like Smart, is considered a “taxpayer” under the NIRC and is directly liable for the tax to be withheld and remitted. This status grants the agent the authority to file a claim for refund, and its relationship with the principal taxpayer (Prism) was deemed irrelevant to this right.
2. **\*\*Characterization of Payments\*\***: The Court analyzed the agreements and determined that only the payment for the SDM program was a royalty, while payments for the CM and SIM Application Agreements were business profits, not subject to Philippines tax as Prism did not have a permanent establishment in the Philippines. Thus, a refund for the overpaid

taxes on these payments was justified.

**### Doctrine:**

The holding established that a withholding agent is entitled to file a refund for taxes erroneously or illegally withheld and remitted, given its status as a “taxpayer” under the NIRC. However, it must return any refunded amount to the principal taxpayer, upholding the principle against unjust enrichment.

**### Class Notes:**

- **\*\*Withholding Agent as a Taxpayer\*\***: A withholding agent is responsible for withholding and remitting taxes and can be considered a taxpayer entitled to file for tax refunds.
- **\*\*Tax Refund Claims\*\***: Must be filed within two years after payment of the tax or penalty, as stipulated under Sections 204(c) and 229 of the NIRC.
- **\*\*Business Profits vs. Royalties\*\***: The distinction between business profits and royalties is crucial in tax treaties, affecting tax liability. Payments for services rendered by a company without a permanent establishment in the host country are classified as “business profits,” generally not taxable in the host country under tax treaties.

**### Historical Background:**

This case reflects the intricate dynamics of international tax obligations and the application of tax treaties in determining tax liabilities, emphasizing the importance of precise definitions and the roles of entities involved in tax withholding and remittance.