Administrative Tax Rule Requiring Prior Tax Treaty Relief Application is a Tax Treaty Override

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I. INTRODUCTION AND PRESENTATION OF THE ISSUE

On 25 August 2010, the Republic of the Philippines' Bureau of Internal Revenue (BIR) issued the new guidelines on the Processing of Tax Treaty Relief Applications (TTRA) Pursuant to Existing Philippine Tax Treaties under Revenue Memorandum Order (RMO) No. 072-10 (RMO No. 72-10).[1]

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1. Bureau of Internal Revenue, Revenue Memorandum Order No. 72-10 [BIR RMO No. 72-10] (Aug. 25, 2010).

Similar to previous TTRA guidelines,[2] RMO No. 72-10 covers the processing of applications for relief from double taxation pursuant to existing Philippine tax treaties, for various income earned in the territory of the Philippines including: (i) Business Profits; (ii) Profits from Shipping and Air Transport; (iii) Dividend Income; (iv) Interest Income; (v) Royalty Income; (vi) Capital Gains; (vii) Income from Services; and (viii) Other Income Earnings.[3]

RMO No. 72-10's stated objective is the streamlining of TTRA processing and prescription of documentary requirements for the processing of such applications for relief from double taxation pursuant to existing Philippine tax treaties in order to improve the BIR's efficiency and service to the taxpayers.[4]

However, RMO No. 72-10 contains a material departure from the previous TTRA guidelines of the BIR in that the failure to file such an application in connection with a transaction covered by a tax treaty, *prior to the first taxable event of such transaction*, will result in the forfeiture of the tax treaty relief or the benefits under the pertinent tax treaty,[5] as follows:

> SECTION 14. *WHEN AND WHERE TO FILE THE TTRA.* — All tax treaty relief applications (updated BIR Forms No. 0901-D, 0901-I, 0901-R, 0901-P, 0901-S, 0901-T, 0901-O and 0901-C) relative to the implementation and interpretation of the provisions of Philippine tax treaties shall only be submitted to and received by the International Tax Affairs Division (ITAD). If the forms or any necessary documents are submitted to any other BIR Office, the application shall be considered as improperly filed.
>
> *Filing should always be made before the transaction.* Transaction for purposes of filing the TTRA shall mean before the occurrence of the first taxable event.
>
> Failure to properly file the TTRA with ITAD within the period prescribed herein shall have the effect of disqualifying the TTRA under this RMO.[6]

A. Implications

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2. These guidelines will be discussed further into the Article.
3. *See* BIR RMO No. 72-10, §§ 4-12.
4. *Id.* § 1.
5. Marietta B. Saludaga, Is tax treaty application a mandatory requirement for refund purposes?, *available at* http://www.punongbayan-araullo.com/pnawebsite/pnahome.nsf/section_docs/SL895C_17-5-11 (last accessed Feb. 19, 2012) and Olivier D. Aznar, "Prior" treaty relief application: A harsh rule?, *available at* http://www.punongbayan-araullo.com/pnawebsite/pnahome.nsf/section_docs/CE043M_6-9-11 (last accessed Feb. 19, 2012).
6. BIR RMO No. 72-10, § 14 (emphasis supplied).

Under RMO No. 72-10, in order for a resident income payor or withholding agent to avail of preferential tax treaty rates on income payments to non-residents, a TTRA should be filed before the first taxable event or before the date the payor or withholding agent is required to file the appropriate tax return and remit the tax withheld.[7] Otherwise, the tax treaty rates will not be allowed and the transacting parties are liable for taxes based on normal rates[8] under the National Internal Revenue Code (NIRC).[9]

In a recent BIR TTRA ruling,[10] where cash dividends were declared and paid to shareholders on 17 January 2011 but the TTRA was filed with the BIR only on 3 March 2011, it was held that the said TTRA was filed beyond the period prescribed in RMO No. 72-10 and was therefore disqualified.[11] The cash dividends were therefore subjected to the normal income tax rate instead of the applicable preferential treaty rate.[12]

In another TTRA ruling,[13] there was a service contract executed on 7 July 2010 whereby a resident of a treaty country was to provide services in the Philippines from November 2010 to February 2011.[14] The TTRA was filed only on 28 February 2011.[15] Here, the BIR likewise held that the TTRA was filed in violation of RMO No. 72-10, and treaty relief was not granted because of the failure to file before the transaction date.[16]

Not only is the filing requirement of filing a TTRA, as set out in RMO 72-10, onerous; said requirement can also become a source of confusion because it could be interpreted to mean that the filing of a separate TTRA is required for every single dividend, royalty, interest payment, and other

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7. Aznar, *supra* note 5.

8. *Id.*

9. An Act Amending the National Internal Revenue Code, as Amended, and for Other Purposes [NATIONAL INTERNAL REVENUE CODE], Republic Act No. 8424 (1997).

10. Bureau of Internal Revenue, Ruling No. ITAD-195-14 [BIR Ruling No. DA-195-14] (July 18, 2011).

11. Ernst & Young, Philippine Government implements strict guidelines for claiming tax treaty relief, *available at* http://www.ey.com/CN/en/Services/Tax/APAC-Tax-Matters---October-2011---Philippines (last accessed Feb. 29, 2012) (citing BIR Ruling No. DA-195-14).

12. *Id.*

13. Bureau of Internal Revenue, Ruling No. ITAD-211-11 [BIR Ruling No. DA-211-11] (Aug. 15, 2011).

14. Ernst & Young, *supra* note 11 (citing BIR Ruling No. DA-211-11).

15. *Id.*

16. *Id.*

similar income-generating transactions, in order for the tax treaty's preferential provisions to become applicable to the same.[17]

And so, it appears that cross-border transactions lawfully entitled to tax treaty benefits are now held hostage, so to speak, by RMO No. 72-10. It is not farfetched to anticipate that business transactions would be delayed pending the release of TTRA rulings.

While it is true that RMO No. 72-10 provides that: (i) the BIR should notify the applicant of lacking documentary requirements within seven days from receipt of the TTRA,[18] and (ii) that the ruling should be released by the BIR after 60 working days from the date of the submission of the complete documentary requirements,[19] the latter is of little succor considering that practitioners have noted that they have yet to see actual issuance of a ruling within the period described above, as is the case with all ruling requests pending with the BIR.[20]

Arguably, RMO No. 72-10 would not be an objectionable administrative rule if the BIR could issue its TTRA rulings within a relatively short period of time, for example, one or two weeks, and if the only objective is to validate or confirm the applicability of preferential tax treaty rates. However, in actual practice, it usually takes the BIR an average of three months to over a year to issue a ruling. Such a turnover period is disadvantageous, even disastrous, to business transactions that thrive on speed and efficiency.[21]

Furthermore, and in support of the observation that RMO No. 72-10 effectively *nullifies tax treaty benefits* in the event that no prior TTRA is filed, the same no longer contains terms and provisions for applications or requests for refund or credit of taxes on pertinent income covered by tax treaties, unlike its predecessor guidelines, RMO No. 1-00.[22]

17. Tata Panlilio-Ong, Clarity on application for relief under tax treaty, *available at* http://www.punongbayan-araullo.com/pnawebsite/pnahome.nsf/section_docs/HO040H_18-10-11 (last accessed Feb. 19, 2012).

18. BIR RMO No. 72-10, § 15, ¶ 3.

19. *Id.* § 15 (i).

20. Joy Formaran-Duclan, The new paradigm in tax rulings, *available at* http://www.punongbayan-araullo.com/pnawebsite/pnahome.nsf/section_docs/QX942W_12-6-07 (last accessed Feb. 29, 2012).

21. *Id.* It has been observed that Bureau of Internal Revenue (BIR) Rulings are "usually released on the average of eight months to more than one year." *Id.*

22. Bureau of Internal Revenue, Revenue Memorandum Order No. 1-2000 [BIR RMO No. 1-00] (Jan. 4, 2000). *Compare* BIR RMO No. 72-10 *with* BIR RMO No. 1-00.

B. Antecedent Developments

The previous guidelines on TTRAs, RMO No. 1-00, also appeared to require a mandatory TTRA, albeit at 15 days prior to the transaction.[23] Paragraph 2, Part III of RMO 1-00 provides the following: "[a]ny availment of the tax treaty relief shall be preceded by an application by filing BIR Form No. 0901 (Application for Relief from Double Taxation) with ITAD at least 15 days before the transaction, i.e., payment of dividends, royalties, etc., accompanied by supporting documents justifying the relief."[24]

However, unlike RMO No. 72-10, RMO No. 1-00 did not contain a provision that states that failure to file a TTRA within the prescribed period shall have the effect of disqualifying such an application or forfeiture of tax treaty benefits.[25] In fact, RMO 1-00 merely directed audit offices of the BIR to simply notify its ITAD of treaty relief availment by taxpayers who are not covered by a TTRA within 15 days from discovery.[26] Additionally, even the BIR's Audit Handbook, BIR Revenue Audit Memorandum Order (RAMO) No. 1-00,[27] instructed examiners to merely request for an ITAD ruling and verify its authenticity.[28] Neither the said Audit Handbook nor RMO No. 1-00 mandated an automatic disqualification for tax treaty benefits in the event that an ITAD ruling is not applied for. More importantly, the RMO No. 1-00 recognized and covered applications or requests for refund or credit of taxes on pertinent income covered by tax treaties.[29] On the contrary, RMO No. 72-10, as stated above, does not.

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23. BIR RMO No. 1-00, part III, ¶ 2.
24. *Id.*
25. *See generally* BIR RMO No. 1-00.
26. *Id.* part IV, ¶ 4.1. Said Paragraph provides: "Notify [International Tax Affairs Division (ITAD)] of any tax treaty relief availment by taxpayers not covered by any application/approval within fifteen (15) days from discovery, by forwarding a report of tax treaty relief availment." *Id.*
27. Bureau of Internal Revenue, Updated Handbook on Audit Procedures and Techniques I, Revenue Audit Memorandum Order No. 1-00 (2000) [BIR RAMO No. 1-00].
28. *Id.*
29. BIR RMO No. 1-00, part II. Said Part provides:

    This Order covers exclusively applications for tax treaty relief, including claims or requests for tax exemption, preferential tax treaty rate, refund[,] or credit of taxes on the following income derived or to be derived by the taxpayer under existing tax treaties, to wit:

    (a) dividends
    (b) interests
    (c) royalties

Furthermore, the "exposure draft" of what became RMO No. 72-10, circulated to the public in 2008, did not make prior-to-transaction TTRAs a mandatory requirement.[30] The said exposure draft provides that the availment of preferential tax rates and exemptions provided under tax treaties need not be preceded by a TTRA.[31] In other words, under the exposure draft, benefits under the tax treaties may immediately be invoked, without securing a ruling from the BIR. To deter abuse, the draft provides a countermeasure — that if "the facts surrounding a subject transaction do not warrant the application of the preferential tax rate or exemption from income tax under tax treaties, the correct amount of taxes and appropriate penalties [will still] be collected from the concerned taxpayers."[32] Unfortunately, these laudable features of the exposure draft never survived.[33]

On the one hand, RMO No. 72-10 has indeed removed the 15-day-prior-to-transaction TTRA pre-requisite and only requires that the TTRA be filed prior to the first taxable event of the subject transaction, an admittedly less-onerous requirement. On the other hand, such failure to file the TTRA prior to the first taxable event of that transaction would unfortunately result to the forfeiture of otherwise applicable tax treaty benefits.

On 7 June 2005, the Court of Tax Appeals (CTA), ruling en banc in *Mirant (Philippines) Corporation v. Commissioner of Internal Revenue*,[34] denied an application for refund of an erroneously withheld tax on payment to a non-resident for its failure to present an ITAD ruling in its favor which necessarily meant that a prior TTRA application was not filed in due

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(d) business profits

(e) gains from sale of shares of stocks

(f) salaries, compensation, etc.

(g) income from services (entertainment, profession, etc.)

(h) profits from the operation of ships and air carriers

(i) all other income covered by tax treaties.

Id.

30. Arnold P. Supilanas, Proposed new rules on tax treaty relief application, *available at* http://www.punongbayan-araullo.com/pnawebsite/pnahome.nsf/section_docs/KS857K_28-10-08 (last accessed Feb. 29, 2012).

31. *Id.*

32. *Id.*

33. *See generally* BIR RMO No. 72-10.

34. Mirant (Philippines) Corporation v. Commissioner of Internal Revenue, CTA Case No. 6382, June 7, 2005.

course.[35] The CTA relied on RMO No. 1-00 which stated that "any availment of the tax treaty relief shall be preceded by an application ... with ITAD at least 15 days before the transaction."[36] However, as discussed above, the CTA ignored the above observation that RMO No. 1-00 does not mandate automatic disqualification from tax treaty relief or benefits in case a favorable ITAD ruling is not secured or a prior TTRA is not filed.[37]

Subsequently, the CTA's decision in *Mirant* was upheld by the Supreme Court (SC), first, in a Resolution[38] to the petitioner's Petition for Review,

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35. *See Mirant (Philippines) Corporation*, CTA Case No. 6382. The Court of Tax Appeals ruled —

> [I]t must be remembered that 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 [apply] 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 that the treaty provisions apply to the said corporation, and that, in cases the same are applicable, the option to avail of the tax benefits under the tax treaty has been successfully invoked.
>
> Under [RMO No. 1-00] of the [BIR], it is provided that the availment of a tax treaty provision must be preceded by an application for a tax treaty relief with its ... [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 [RMO] 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.
>
> 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.

Mirant (Philippines) Corporation, CTA Case No. 6382.

36. BIR RMO No. 1-00, part III, ¶ 2.

37. *See Mirant (Philippines) Corporation*, CTA Case No. 6382.

38. Mirant (Philippines) Corporation v. Commissioner of Internal Revenue, G.R. No. 168531, Nov. 12, 2007 (unreported).

and second, in a Minute Resolution[39] to the petitioner's Motion for Reconsideration.

Currently, *Mirant* is the controlling jurisprudence in the area of TTRAs, and the CTA has relied upon it in several cases,[40] where it denied claims for refunds based on tax treaty benefits due to the failure to file TTRAs in due course.

Since the SC's upholding of the CTA ruling in *Mirant*, the BIR, through RMO No. 72-10, has been imposing a substantive and very onerous condition precedent for the availment of benefits or preferential rates provided under tax treaties — treaties which are generally understood as having the force and effect of local or domestic law.

II. STATEMENT OF POSITION

This Article will examine why RMO No. 72-10 and, in particular, its mandatory and punitive prior-to-transaction TTRA requirement are both: (1) an *ultra vires* administrative rule and (2) a tax treaty override contrary to public international law.

III. REVIEW OF PERTINENT CONCEPTS

In order to properly understand the position being presented, a brief review of the pertinent concepts of treaties, tax treaties, administrative rules, and treaty overrides, will be instructive.

A. Treaties

1. Treaties in General

Article 38 of the Statute of the International Court of Justice[41] establishes the following as sources of international law: (i) international conventions, or treaties; (ii) international custom, as evidence of a general practice accepted

39. Mirant (Philippines) Corporation v. Commissioner of Internal Revenue, G.R. No. 168531, Feb. 18, 2008 (unreported).

40. Deutsche Bank AG Manila Branch v. CIR, CTA Case No. 7344, May, 29, 2009; CIR v. CBK Power Company Limited, CTA Case Nos. 6699, 6884, & 7166, Mar. 29, 2010; and Manila North Tollways Corporation (MNTC) v. CIR, CTA Case No. 7864, Apr. 12, 2011.

41. Statute of the International Court of Justice art. 38, June 26, 1945, 33 U.N.T.S. 993. As described in the International Court of Justice's website: "The Statute of the International Court of Justice is annexed to the Charter of the United Nations, of which it forms an integral part. The main object of the Statute is to organize the composition and the functioning of the Court." International Court of Justice, Statute of the Court, *available at* http://www.icj-cij.org/documents/index.php?p1=4&p2=2&p3=0 (last accessed Feb. 19, 2012).

as law; (iii) general principles of law recognized by civilized nations; and, (iv) as subsidiary means for determining rules of law, judicial decisions, and teachings of most highly qualified publicists.[42]

Under Article 2 (1) (a) of the Vienna Convention on the Law of Treaties (Vienna Convention),[43] a treaty is defined as "an international agreement concluded between States[,] in written form[,] and governed by international law, whether embodied in a single instrument or in two or more related instruments, and whatever [their name, title, or particular] designation."[44]

Section 2, Article II of the 1987 Constitution of the Republic of the Philippines (Constitution) provides that it adopts the generally accepted principles of international law as part of the law of the land, and treaties are considered as one of the sources international law.[45] This is also known as the "Incorporation Clause" of the Constitution.[46]

As per Section 21, Article VII of the 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."[47] This is also known as the "Treaty Ratification Clause" of the Constitution. Thus, under the present form of the Constitution, treaties are subject to the following structure or framework: (i) the Executive branch negotiates and signs treaties; (ii) the Legislative branch, through the Senate, ratifies treaties; and (iii) the Judicial branch reviews the constitutionality of treaties, even after their ratification by the Senate.[48]

Without a doubt, treaties are binding contracts between sovereign states, being the direct and actual parties that entered into them. However, what are the implications or effects of treaties on the domestic or municipal laws of the state-parties?

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42. *Id.*

43. Vienna Convention on the Law of Treaties art. 2 (1) (a), May 23, 1969, 1155 U.N.T.S. 331 [hereinafter Vienna Convention].

44. *Id.*

45. PHIL. CONST. art. II, § 2. The said Section provides: "The Philippines renounces war as an instrument of national policy, adopts the generally accepted principles of international law as part of the law of the land, and adheres to the policy of peace, equality, justice, freedom, cooperation, and amity with all nations." *Id.*

46. Bayan Muna v. Romulo, 641 SCRA 244, 257 (2011) (citing ISAGANI A. CRUZ, PHILIPPINE POLITICAL LAW 55 (1995)).

47. PHIL. CONST. art. VII, § 21.

48. The Supreme Court has the power of judicial review over the constitutionality of any treaty, international, or executive agreement and must hear such cases en banc. *See* PHIL. CONST. art. VIII, §§ 4 (2) & 5 (2) (a).

In the Philippines, the prevailing theory is the doctrine of incorporation — that treaties, upon ratification by the legislature, are automatically incorporated as part of Philippine law by virtue of the Incorporation Clause or Section 2, Article II of the Constitution.[49] In *Agustin v. Edu*,[50] the Supreme Court held that the Philippine ratification of the Vienna Convention on International Road Signs provided sufficient basis for the Land Transportation Office to require all vehicles to have early warning devices, even if the Philippine Congress had not yet passed a statute implementing the said treaty.[51] Furthermore, in *Secretary of Justice v. Lantion*,[52] it was held that "[u]nder the doctrine of incorporation, rules of international law form part of the law of the land, and no further legislative action is needed to make such rules applicable in the domestic sphere."[53]

Treaties, therefore, are part of the Philippines' local or domestic law, having the same force and effect as statutes passed by Congress, and can be invoked in Philippine courts by party litigants.

2. Tax Treaties

Tax treaties are treaties designed to mitigate the effects of double taxation, brought about by cross-border transactions.[54] These treaties tend to reduce the taxes imposed by one state-party for residents of the other state-party in order to reduce double taxation in the same income. The usually stated goals for negotiating and entering into a tax treaty often include the following: (i) reduction of double taxation; (ii) elimination of tax evasion; and (iii) increase of cross-border trade efficiency.[55]

Tax treaties, like all other treaties, are to be interpreted and implemented in accordance with the provisions of public international law relating to treaties.[56] This also means that tax treaties have "the legal effects of any other

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49. Secretary of Justice v. Lantion, 322 SCRA 160, 196 (2000) (citing JOVITO R. SALONGA & PEDRO L. YAP, PUBLIC INTERNATIONAL LAW 12 (1992 ed.)).

50. Agustin v. Edu, 88 SCRA 195 (1979).

51. *Id.* at 213.

52. *Lantion*, 322 SCRA 160 (2000).

53. *Id.* at 196 (citing JOVITO R. SALONGA & PEDRO L. YAP, PUBLIC INTERNATIONAL LAW 12 (1992 ed.)).

54. *See* Anthony C. Infanti, *Curtailing Tax Treaty Overrides: A Call to Action*, 62 U. PITT. L. REV. 677, 678-79 (2001).

55. Michael J. McIntyre, Legal Structure of Tax Treaties (A Discussion on the Legal Nature of Tax Treaties) 1, *available at* http://faculty.law.wayne.edu/mcintyre/Text/Classes/intl_class/Legal_nature_tax_treaties.pdf (last accessed Feb. 19, 2012).

56. *Id.* at 1.

treaty."[57] Tax treaties — as a whole or many aspects of such — are self-executing and do not require any further legislative action, other than ratification, to become effective.[58] In any event, the aforediscussed Incorporation Clause and Treaty Ratification Clause of the Constitution may be considered as giving binding legislative effect to senate-ratified tax treaties of the Philippine State.

The NIRC, as amended, for its part, recognizes the effects and benefits of tax treaties, by particularly and explicitly exempting from Philippine income taxation "income exempt under treaty." To wit:

> SEC. 32. Gross Income. —
>
> ...
>
> (B) *Exclusions from Gross Income.* — The following items shall not be included in gross income and shall be *exempt from taxation* under this Title:
>
> ...
>
> (5) *Income Exempt under Treaty.* — Income of any kind, to the extent required by any treaty obligation binding upon the Government of the Philippines.[59]

As of writing, the Philippines has 40 bilateral tax treaties in force.[60] Most, if not all, of these are based in large part on the Model Tax Treaty and accompanying commentaries prepared by the Organisation for Economic Co-operation and Development (OECD)[61] or the model treaty and commentaries prepared by the United Nations (UN).[62]

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57. *Id.* at 8.
58. *Id.*
59. NATIONAL INTERNAL REVENUE CODE, § 32.
60. The Philippines has tax treaties with the following countries: Australia, Korea, Austria, Malaysia, Bahrain, Netherlands, Bangladesh, New Zealand, Belgium, Norway, Brazil, Pakistan, Canada, Poland, Chile, Romania, China, Russian Federation, Czech Republic, Singapore, Denmark, Spain, Finland, Sweden, France, Switzerland, Germany, Thailand, Hungary, Turkey, India, United Arab Emirates, Indonesia, United Kingdom, Israel, United States of America, Italy, Vietnam, Japan, and Yugoslavia.
61. *See generally* Organisation for Economic Co-operation and Development, Articles of the OECD Model Tax Convetion on Income and Capital, *available at* http://www.oecd.org/dataoecd/25/24/47213736.pdf (last accessed Feb. 29, 2012) [hereinafter OECD Model Tax Treaty]. The OECD Model Tax Treaty has three versions dated July 2005, July 2008, and July 2010. The Philippines is not a member of OECD but observes or participates in the latter's committees.
62. U.N. ECON. & SOC. COUNCIL, UNITED NATIONS MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES, U.N. Doc. ST/ESA/PAD/SER.E/21 (2001) [hereinafter U.N. MODEL DOUBLE TAXATION CONVENTION].

In "The Harmonization of Tax Treaties and Domestic Law," international tax expert Dr. Sung-Soo Han discussed how the OECD Model Tax Treaty influenced the negotiation, application, and interpretation of tax treaties, considering the fact that most bilateral tax treaties, whether or not they were made by OECD member states, conform to the structure of the said model treaty.[63] Moreover, it is also observed that the OECD Model Tax Treaty served as the template for the later UN Model Tax Treaty.[64] Even though the OECD's membership is limited to industrialized countries, the OECD Model Tax Treaty "has achieved a consensus position as the benchmark against which essentially all tax treaty negotiations take place," a scope even broader than that covered by the UN Model Tax Treaty.[65] Likewise, the OECD Commentaries thereon have become the acknowledged guide to the interpretation and application of the tax treaties.[66]

B. Tax Treaty Overrides

Under the international law principle of *pacta sunt servanda*, which is also incorporated in the Vienna Convention,[67] "every treaty in force is binding upon the parties to it and must be performed by them in good faith."[68] Moreover, the Vienna Convention likewise states that "a party may not invoke the provisions of its internal law as justification for its failure to perform a treaty."[69]

In its most basic sense, a treaty override is the breach being sought to be prevented by the aforementioned provisions of the Vienna Convention. Otherwise stated, a treaty override is the partial or total (i) exclusion or setting-aside of a treaty, or (ii) the negation or nullification of its effects or benefits, by a treaty-party or member by a deliberate act of supervening domestic legislation or statute.[70]

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63. *See* Sung-Soo Han, *The Harmonization of Tax Treaties and Domestic Law*, 7 BYU INT'L L. & MGMT. REV. 29, Spring 2011, at 29 [hereinafter Harmonization].

64. U.N. MODEL DOUBLE TAXATION CONVENTION, *supra* note 62, at *vi*.

65. Peter A. Barnes, A Model to Celebrate, *available at* http://www.oecdobserver.org/news/fullstory.php/aid/2742/ (last accessed Feb. 19, 2012).

66. U.N. MODEL DOUBLE TAXATION CONVENTION, *supra* note 62, at *xxi*.

67. Vienna Convention, *supra* note 43, art. 26. The Article provides for the definition of "*pacta sunt servanda*," which means that "[e]very treaty in force is binding upon the parties to it and must be performed by them in good faith." *Id.*

68. *Id.*

69. *Id.* art. 27. The Article provides that "[a] party may not invoke the provisions of its internal law as justification for its failure to perform a treaty." *Id.*

70. Harmonization, *supra* note 63, at 41.

For its part, the OECD defines a treaty override as follows: (i) "'treaty override' refers to a situation where the domestic legislation of a State overrules provisions of either a single treaty or all treaties hitherto having had effect in that state"[71] and (ii) "the enactment of domestic legislation intended by the legislature to have effects in clear contradiction to international treaty obligations."[72]

Although the following are related issues, tax treaty overrides *per se* are not concerned with (i) the interpretation of tax treaty terms and provisions, and (ii) the application of domestic anti-tax evasion rules to tax treaties.[73]

C. Administrative Rules

1. Administrative Rules in General

Administrative rules are basically the issuances of administrative agencies meant to implement specific laws entrusted to the latter. Administrative agencies refer "to any of the various units of the [g]overnment, including a department, bureau, office, instrumentality, or government-owned or controlled corporation [(GOCC)], or a local government or distinct unit therein."[74] The BIR is one such administrative agency and is concerned with "the assessment and collection of all national internal revenue taxes, fees, and charges, and the enforcement of all forfeitures, penalties, and fines connected therewith, including the execution of judgments in all cases decided in its favor by the [CTA] and the ordinary courts."[75]

Administrative rules or regulations are the "product[s] of rule making, and rule making is the part of the administrative process that resembles a legislature's enactment of a statute."[76] In Philippine jurisdiction,

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71. Organisation for Economic Cooperation and Development Committee on Fiscal Affairs, *Tax Treaty Override, in* 2 ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT COMMITTEE ON FISCAL AFFAIRS, MODEL TAX CONVENTION ON INCOME AND ON CAPITAL R(8)-3 (2000).

72. *Id.* at R(8)-4.

73. Sung-Soo Han, Establishment of Principle for Prevention of Treaty Override (Excerpts from the Author's Doctoral Thesis for English Publication) 14-19, *available at* http://works.bepress.com/cgi/viewcontent.cgi?article=1000&context=sung_soo_han (last accessed Feb. 19, 2012) [hereinafter Prevention of Treaty Override].

74. Office of the President, Instituting the "Administrative Code of 1987", Executive Order No. 292 [ADMINISTRATIVE CODE], § 2 (4) (1987).

75. NATIONAL INTERNAL REVENUE CODE, § 2.

76. Balmaceda v. Corominas & Company, Inc., 66 SCRA 553, 562 (1975) (citing KENNETH CULP DAVIS, ADMINISTRATIVE LAW TREATISE 275 (1958)) (emphasis omitted).

administrative agencies are vested with the power to implement a statute and to effectuate its policies and when promulgated, such administrative rules and regulations have the force and effect of a valid law.[77] The rationale or justification for this delegation of power was given in *United States v. Tupasi Molina*,[78] where it was held that:

> In the very nature of things in many cases[,] it becomes impracticable for the [L]egislative department of the Government to provide general regulations for the various and varying details for the management of a particular department of the Government. It therefore becomes convenient for the [L]egislative department of the Government, by law, in a most general way, to provide for the conduct, control, and management of the work of the particular department of the Government [and] to authorize certain persons, in charge of the management, control, and direction of the particular department, to adopt certain rules and regulations providing for the detail of the management and control of such department. Such regulations have uniformly been held to have the force of law, whenever they are found to be in consonance and in harmony with the general purposes and objects of the law. Many illustrations might be given. For instance, the Civil Service Board is given authority to examine applicants for various positions within the Government service. The law generally provides the conditions in a most general way, authorizing the chief of such Bureau to provide rules and regulations for the management of the conduct of examinations, etc. The law provides that the Collector of Customs shall examine persons who [apply] to act as captains of ships for the coastwise trade, providing at the same time that the Collector of Customs shall establish rules and regulations for such examinations. Such regulations, once established and found to be in conformity with the general purposes of the law, are just as binding upon all of the parties, as if the regulations had been written in the original law itself.[79]

To reiterate, these rules and regulations, when promulgated in pursuance of the procedure or authority conferred upon the administrative agency by law, partake of the nature of a statute. According to jurisprudence,

> [t]his is so because statutes are usually couched in general terms, after expressing the policy, purposes, objectives, remedies[,] and sanctions intended by the [L]egislature. The details and the manner of carrying out the law are often left to the administrative agency entrusted with its enforcement. In this sense, it has been said that rules and regulations are the

77. *Balmaceda*, 66 SCRA at 562.

78. United States v. Tupasi Molina, 29 Phil. 119 (1914).

79. *Id.* at 125 (citing United States v. Grimaud, 220 U. S. 506 (1911); Williamson v. United States, 207 U. S. 425 (1908); and United States v. United Verde Copper Co., 196 U. S. 207 (1905)).

> products of a delegated power to create new or additional legal provisions that have the effect of law.[80]

Hence, such administrative rules and regulations are considered to be "legislative" in nature.

There is another kind of administrative rule — those which are "interpretative" in nature.[81] This kind of rule is created when an administrative agency "renders an opinion" or gives a statement of policy "and merely interprets a pre-existing law."[82]

The difference in the binding effects of legislative and interpretative rules was laid out in *Victoria's Milling Co., Inc. v. Social Security Commission*,[83] as follows:

> A rule is binding on the courts so long as the procedure fixed for its promulgation is followed and its scope is within the statutory authority granted by the legislature, even if the courts are not in agreement with the policy stated therein or its innate wisdom[.] On the other hand, administrative interpretation of the law is[,] at best[,] merely advisory, for it is the courts that finally determine what the law means.[84]

However, settled is the rule that "*in case of discrepancy* between the basic law and a rule or regulation issued to implement said law, [whether such rule is legislative or interpretative in nature,] the basic law prevails, because the said rule or regulation cannot go beyond the terms and provisions of the basic law."[85]

2. Tax Administrative Rules

The head of the BIR, the Commissioner of Internal Revenue (CIR), has the power to issue administrative rules or rulings (BIR Rulings and Issuances)[86]

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80. Victoria's Milling Co., Inc. v. Social Security Commission, 4 SCRA 627, 630 (1962) (citations omitted).

81. *Victoria's Milling Co., Inc.*, 4 SCRA at 630.

82. *Id.*

83. *Id.* at 627.

84. *Id.* at 630 (citations omitted).

85. Philippine Amusement and Gaming Corporation (PAGCOR) v. Bureau of Internal Revenue, 645 SCRA 338, 365 (2011) (citing Hijo Plantation, Inc. v. Central Bank, 247 Phil. 154, 162 (1988)) (emphasis supplied).

86. Bureau of Internal Revenue, Revenue Administrative Order No. 2-01 [BIR RAO No. 2-01], § 3 (Oct. 22, 2001). The various kinds or classes of BIR issuances are described in detail in Section 3 of BIR RAO No. 2-01, to wit:

> SECTION 3. Classification of BIR Rulings and Issuances — The following terms shall have the meaning described below:

(a) Rulings of first impression — These refer to the rulings, opinions, and interpretations of the Commissioner of Internal Revenue with respect to the provisions of the Tax Code and other tax laws without established precedent, and which are issued in response to a specific request for ruling filed by a taxpayer with the Bureau of Internal Revenue. Provided, however, that the term shall include reversal, modification, or revocation of any existing ruling.

(b) Rulings with established precedents — These refer to mere reiteration of previous rulings, opinions, and interpretations of the Commissioner, as delegated to duly authorized internal revenue officers (i.e., Deputy Commissioner, Legal and Inspection Group; Assistant Commissioner, Legal Service; Regional Directors) that are issued in response to a specific request for ruling filed by a taxpayer with the Bureau of Internal Revenue.

(c) Revenue Memorandum Rulings (RMR) — These refer to the rulings, opinions, and interpretations of the Commissioner of Internal Revenue with respect to the provisions of the Tax Code and other tax laws, as applied to a specific set of facts, with or without established precedents, and which the Commissioner may issue from time to time for the purpose of providing taxpayers guidance on the tax consequences in specific situations.

(d) Revenue Travel Assignment Orders (RTAO) — These orders assign revenue personnel to specific functions in specific units. Travel assignment orders specifically mention the names of revenue personnel concerned.

(e) Revenue Special Orders (RSO) — Instructions or directives for the accomplishment of special assignments or missions of significance which are temporary in nature or for a definite period of time. These issuances specifically mention the personnel or units of organization concerned.

(f) Revenue Memorandum Circulars (RMC) — These issuances shall disseminate and embody pertinent and applicable portions, as well as amplifications of the rules, precedents, laws, regulations, opinions, and other orders and directives issued by or administered by the Commissioner of Internal Revenue, and by offices and agencies other than the Bureau of Internal Revenue, for the information, guidance, or compliance of revenue personnel.

(g) Revenue Memorandum Orders (RMO) — These are directives or instructions outlining procedures, techniques, methods, processes, operations, activities, work flow, and the like, which are necessary to carry out programs or to achieve policy goals and objectives. These issuances may be of general or of limited scope yet in any case require definite compliance

like the subject revenue memorandum order because, under Section 4 of the NIRC, the CIR has the power to interpret tax laws and decide tax cases, to wit:

> SEC. 4. *Power of the Commissioner to Interpret Tax Laws and to Decide Tax Cases.* — The power to interpret the provisions of this Code and other tax laws shall be under the exclusive and original jurisdiction of the Commissioner, subject to review by the Secretary of Finance.[87]

The BIR issuance relating to TTRAs is classified as an RMO which is described as follows by Section 3 (g) of Revenue Administrative Order (RAO) No. 2-01:

> These are directives or instructions outlining procedures, techniques, methods, processes, operations, activities, work flow, and the like, which are necessary to carry out programs or to achieve policy goals and objectives. These issuances may be of general or of limited scope yet in any case require definite compliance by those concerned. They are not addressed to any particular group of employees or offices because they are for general information, but those directly concerned with the compliance of these provisions are either definitely stated, or unmistakably implied thereat.[88]

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by those concerned. They are not addressed to any particular group of employees or offices because they are for general information, but those directly concerned with the compliance of these provisions are either definitely stated, or unmistakably implied thereat.

(h) Revenue Audit Memorandum Orders (RAMO) — These refer to the uniform audit procedures to be observed by revenue officers in the conduct of audit of tax cases and in their submission of reports of investigation.

(i) Revenue Delegation of Authority Orders (RDAO) — These refer to the functions delegated by the Commissioner to revenue officers in accordance with law.

(j) Revenue Administrative Orders (RAO) — These refer to matters that deal strictly with more or less permanent administrative set-up of the Bureau. Delineation of organizational structures, statements of functions and/or responsibilities, definitions and delegations of authority, staffing and personnel requirements, standards of performance, establishment of Bureau-wide programs, installation of systems, and the like, are most likely subject matter of Revenue Administrative Orders. These issuances are for general guidance, compliance, and/or information.

Id.

87. NATIONAL INTERNAL REVENUE CODE, § 4.

88. BIR RAO No. 2-01, § 3 (g).

IV. DISCUSSION

To recapitulate, RMO No. 72-10 provides that failure to file a TTRA in connection with a transaction covered by a tax treaty, *prior to the first taxable event of such transaction*, will result in the forfeiture or non-application of the relevant relief or benefits under the pertinent tax treaty.[89] RMO 72-10 actually creates an additional requirement for the claiming of tax treaty benefits that is not present in any of the Philippines' tax treaties in force.

A. RMO No. 72-10 is an Ultra Vires Administrative Rule

There is no doubt that the BIR, through the CIR, has the power to issue administrative rules.[90] However, upon examination of the substance of the RMO No. 72-10, it appears that it has exceeded its parameters, which would be: (i) the terms and provisions of the tax treaties themselves, (ii) Section 4 of the NIRC, and (iii) Section 3 (g) of RAO No. 2-01.

As discussed in Part III, the Philippines follows the doctrine of incorporation. Hence, tax treaties have the force and effect of law. Therefore, as far as the BIR is concerned, its administrative rules meant for the enforcement of tax treaties are bound by the terms and provisions of the same tax treaties. This is clear even under the wordings of the aforequoted Section 4 of the NIRC, which provides that the CIR's power is only the "power to interpret the provisions of [the NIRC] and other tax laws."[91]

Moreover, under RAO No. 2-01, RMOs are only supposed to be "directives or instructions outlining procedures, techniques, methods, processes, operations, activities, work flow, and the like."[92] RMO No. 72-10, with its substantive or "legislative-in-nature" prior-to-transaction TTRA rule, does not fit this definition. Going by the definition of an RMO, such would ordinarily be deemed to be an interpretative rule, as discussed in Part III above, as these RMOs *per se* were not meant to create "a new law with the force and effect of a valid law[.]"[93] However, RMO No. 72-10 itself appears to be in the nature of a "legislative" administrative rule considering the substantive and punitive nature of its controversial prior-to-transaction TTRA requirement.

RMO No. 72-10's TTRA requirement also unduly discriminates between two kinds of taxpayers: (i) taxpayers liable under local laws and (ii) taxpayers liable under tax treaties. The discrimination lies in the fact that

89. BIR RMO No. 72-10, § 14, ¶ 3.

90. Subject to review by the Secretary of Finance, as per Section 4 of the National Internal Revenue Code. NATIONAL INTERNAL REVENUE CODE, § 4.

91. *Id.*

92. BIR RAO No. 2-01, § 3 (g).

93. *Victoria's Milling Co., Inc.*, 4 SCRA at 630.

taxpayers under local laws have no need to file for prior-to-transaction relief applications for them to apply local tax law rates in their returns and payments. This is clearly derogatory to the aforediscussed Section 32 (B) (5) of the NIRC, which already statutorily or by law exempts from taxation income exempt under treaty.[94] While the argument may be made that there is a substantial distinction between local law taxpayers and tax treaty taxpayers, the same Section 32 (B) (5) of the NIRC already affords the latter sufficient legal basis for equal treatment.

B. RMO No. 72-10 is a Tax Treaty Override

RMO No. 72-10 is a tax treaty override because it creates a new requirement for the claiming of tax treaty benefits that is not present in any of the Philippines' current tax treaties. This fits in with the definition of treaty overrides because the failure to comply with the administrative requirement of prior filing of relief application with the BIR's ITAD is penalized, not with mere fines or other permissible administrative reprimand, but with the denial or non-application of treaty benefits in the form of preferential rates or tax exemption or the denial of claims for tax refund or credit, as the case may be.

Additionally, RMO No. 72-10's prior-to-transaction TTRA requirement is contrary to the non-discrimination clauses found in tax treaties which prohibit a state-party from imposing requirements that are more burdensome than the requirements being imposed by the other state-party.[95] The leading provision of this type of clause generally appears as follows:

> Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same

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94. NATIONAL INTERNAL REVENUE CODE, § 32. The Section provides:

> SEC. 32. Gross Income. —
>
> ...
>
> (B) *Exclusions from Gross Income.* — The following items shall not be included in gross income and shall be *exempt from taxation* under this Title:
>
> ...
>
> (5) *Income Exempt under Treaty.* — Income of any kind, to the extent required by any treaty obligation binding upon the Government of the Philippines.

Id. (emphasis supplied).

95. William C. Gifford, *Permanent Establishments under the Nondiscrimination Clause in Income Tax Treaties*, 11 CORNELL INT'L L.J. 51, 51-52 (1978).

> circumstances, in particular with respect to residence, are or may be subjected.[96]

Even though RMO No. 72-10 is not an act of the legislature, it is in the nature of a treaty override because what is essential in meeting the definition of a treaty override is the fact of "exclusion of a treaty" or the "negation of its effects."[97] Even granting, without conceding, that only an act of legislature can ever become a treaty override, RMO No. 72-10 has the force and effect of law under Philippine jurisprudence, because it is an administrative rule that is valid and effective until struck down by the Judiciary. As of writing, RMO No. 72-10 is in force, as it has not been successfully challenged, struck down, or even been suspended via an injunction.

As discussed earlier, a treaty override is inconsistent with the fundamental international law principle of *pacta sunt servanda*, codified in Articles 26 and 31 (1)[98] of the Vienna Convention which also provide that treaties should be implemented in good faith. In line with this, Article 27 of the Vienna Convention states that a treaty party may not invoke its internal law as justification for its failure to perform its treaty obligations.[99]

Additionally, according to Klaus Vogel[100] — the world's best known international tax publicist — tax treaties are considered to be "high authority" and "special legislation" which have a hierarchical position that is prioritized over general domestic or local legislation, to wit:

> Being restricted to cross-border taxation of residents of the two contracting States, tax treaties are equivalent to special legislation (*legs speciales*) compared to the contracting States' general tax law (*lex generalis*). Thus according to the old rule '*Lex specialis derogat legi genarali*' ('Special legislation overrides general legislation'), treaties override the domestic tax law that is effective at the time of their implementation. Under [the] supplementary rule of '*Lex posterior generalis non derogart legi priori speciali*' ('Later general legislation does not overrule earlier special legislation'), changes of domestic tax law normally will not affect existing treaties. This later rule does not apply, however, if the legislator, when changing the general law, expressly or implicitly intended to repeal the special law.

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96. OECD Model Tax Treaty, *supra* note 61, art. 24 (1).

97. Harmonization, *supra* note 63, at 41.

98. Vienna Convention, *supra* note 43, arts. 26 & 31 (1). Article 31 (1) provides: "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." *Id.* art. 31 (1).

99. *Id.* art. 27.

100. Emeritus professor at the University of Munich, renowned legal theorist on tax treaties, author of 15 books and approximately 200 journal articles, prior to his passing in 2007. Harmonization, *supra* note 63, at 44.

> General law then overrules the special (domestic) legislation. *A legislation that contradicts an existing international treaty, however, is a violation of international law.*[101]

Thus, under Vogel's position: (i) subsequent general legislation by a state-party does not override previous special legislation, and, therefore, tax treaties will remain in force, despite newer and contrary domestic tax law; and (ii) local legislation that is contradictory to existing treaty is a breach of international law.[102]

Tax treaties experts Jan Wouters[103] and Maarten Vidal[104] are of a similar position with Vogel. They opined that tax treaty overrides are unlawful under international law even if they are considered lawful under pertinent domestic law:

> *Even if a tax treaty override is perfectly lawful under the municipal law of the overriding State, and even if there are good economic reasons for it, it is very likely that the application of this legislation will be unlawful under international law.* Hence, the overriding State's international responsibility will be incurred unless circumstance precluding wrongfulness can be demonstrated. These circumstances are to be interpreted restrictively and have to be proven by the overriding State.[105]

The OECD Commentaries appear to support the positions of the above experts as it provides that the application of domestic laws that counter tax-evasion or tax treaty abuse should be done with regard to the primacy of tax treaties and not lead to a result that may override unilaterally the obligations imposed by such tax treaties.[106]

Hence, if a domestic statute that is violative of a treaty is considered a breach of international law, then a treaty-nullifying administrative rule, like the subject RMO, can likewise be a treaty violation.

C. Defensible Treaty Overrides

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101. Prevention of Treaty Override, *supra* note 73, at 12-13 (citing Klaus Vogel, *Chapter 1 The Domestic Law Perspective*, *in* 2 TAX TREATIES AND DOMESTIC LAW 3 (Guglielmo Maisto ed., 2006)) (emphasis supplied).

102. Harmonization, *supra* note 63, at 44.

103. Professor of International Law and the Law of International Organizations, Catholic University of Leuven. Prevention of Treaty Override, *supra* note 73, at 132 n.18.

104. Researcher, Institute for International Law, Catholic University of Leuven. *Id.* at n.19.

105. Prevention of Treaty Override, *supra* note 73, at 13 (citing Jan Wouters & Maarten Vidal, *Chapter 2 The International Law Perspective*, *in* 2 TAX TREATIES AND DOMESTIC LAW 34 (Guglielmo Maisto ed., 2006)) (emphasis supplied).

106. U.N. Model Double Taxation Convention, *supra* note 62, at *xiv*.

However, according to United States (US) tax treaties expert Michael J. McIntyre, tax treaty overrides that are still compatible with the requirements of international law may still be considered as defensible. He describes three non-exclusive categories of treaty overrides that do not violate international law: (1) interpretative overrides, (2) non-material overrides, and (3) prospective overrides that have been or may be acceded to by treaty partners.[107] Is it possible that RMO No. 72-10 fits any of these categories, thus making it a defensible treaty override?

1. Interpretative Overrides

Interpretative overrides are domestic statutes (or even administrative rules, as this Article opines) which merely interpret or define certain terms and provisions of tax treaties. Under this description, RMO No. 72-10 cannot be considered a mere interpretative override because it actually adds a condition precedent for the claiming of tax treaty benefits not present in the tax treaties it seeks to implement.

As a corollary, there is the position that, in the absence of clear guidance provided in treaties themselves, the mere interpretation of "terms" and "provisions" of a treaty may be performed by state-parties by reference to its own domestic law without such being considered an override.[108] Even the OECD Model Tax Treaty adopts this position, as Article 3 (2) thereof provides the following:

> As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.[109]

However, even under this related concept of allowable interpretations, RMO No. 72-10 cannot be considered a mere interpretative rule for the following reasons: (i) it does not purport or even appear to interpret any specific term or provision of vague quality in its establishment of the prior TTRA rule and (ii) it does not even refer to any Philippine law as basis for the said prior TTRA rule, other than, of course, the BIR's broad power to issue tax rules.

107. Michael J. McIntyre, A Defense of Treaty Overrides (An Article in McIntyre Notebook) 1, *available at* http://faculty.law.wayne.edu/mcintyre/text/mcintyre_articles/Treaties/NBK1-6.pdf (last accessed Feb. 19, 2012) [hereinafter Defense of Overrides].

108. Harmonization, *supra* note 63, at 39-40.

109. OECD Model Tax Treaty, *supra* note 61, art. 3 (2).

2. Non-material Overrides

On the other hand, non-material overrides are those whose breach of treaty is not material or serious. According to McIntyre, "[t]he doctrine of *pacta sunt servanda* does not prohibit all breaches of treaties[,]"[110] and that to violate international law, the breach must be serious or "material."[111] As to what constitutes a "serious breach," tribunals have traditionally utilized a "facts and circumstances test."[112] For his part, McIntyre believes that "a breach of a tax treaty, to be material, must take away from a treaty signatory a significant bargained-for benefit and must undermine the objectives of the breached treaty."[113]

Under this standard, RMO No. 72-10 cannot be considered a non-material override because the residents of the Philippines' counterpart treaty signatories will not be given their tax treaty benefits in case of failure to comply with a local administrative requirement that has no basis in the tax treaties nor in Philippine law. Furthermore, McIntyre declares that he "would criticize, under almost any circumstance, a breach of a tax treaty that [he] considered to be a material breach under international law."[114]

3. Prospective Overrides

Finally, prospective overrides are statutes that merely announce the intention of a state-party to an existing treaty to override limitations (provided in the same treaty) on its powers to tax particular items of income. The purpose of this type of override is to facilitate treaty negotiations.[115] Obviously, RMO No. 72-10 cannot be a prospective override because it is not declarative in nature nor does it even purport to require the consent of the Philippines' tax treaty partners. Moreover, unlike the previous two categories of defensible treaty overrides, only the legislative branch can draft a prospective override.

V. CONCLUSION

Tax treaty overrides, especially those which are material in nature, are blatant threats to the stability of tax treaties and international trade and commerce. In the first place, such treaty overrides fly in the face of the principle of *pacta sunt servanda*, which is codified in the Vienna Convention. To recapitulate, the Vienna Convention also provides that "every treaty in force is binding

110. Defense of Overrides, *supra* note 107, at 3.

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.* at 1.

115. *Id.* at 4.

upon the parties to it and must be performed by them in good faith."[116] The Vienna Convention also stresses that "a party may not invoke the provisions of its internal law as justification for its failure to perform a treaty."[117] The OECD likewise urges its members and all countries to refrain from treaty overrides.

Regardless of their nature, whether enacted by a state-party's legislature or tax administrative agency (i.e., the BIR), tax treaty overrides are detrimental to domestic interests because treaty partners will eventually insist upon the right to renegotiate or even retaliate in kind.

In light of the analysis conducted above on the merits of RMO No. 72-10, under both administrative law and international law, the BIR should kindly consider revisiting its prior-to-transaction TTRA requirement and hopefully revoke, or at least amend, the same. In reconsidering RMO No. 72-10, it is respectfully recommended that the said laudable features of the "exposure draft" of RMO No. 72-10, discussed in Part I, be implemented.

The US' Internal Revenue Service (IRS) does not have such a punitive TTRA requirement. It merely requires the non-resident income recipient to notify the payor of the income (the withholding agent) of his or its foreign status to claim the benefits of the treaty by filing the prescribed IRS forms with the said withholding agent,[118] subject of course to post-audit by the IRS, which would mean fines and penalties for erroneous or fraudulent treaty benefits application. As it turns out, this would appear to be the practice in the Philippines before TTRAs became a condition precedent for enjoying treaty benefits.

The Authors of this Article are not unaware of the primary practical advantage of RMO 72-10's TTRA requirement, which is that income payors will not be allowed to remit their payments to non-residents without an examination and ruling by the BIR, thereby limiting tax evasion. However, such a practice is not only derogatory to the various laws and principles discussed above, but also counter-productive to international trade, because of its undeniable dilatory effects.

In the World Bank and the International Finance Corporation's Ease of Doing Business Ranking for 2012,[119] the Philippines ranked 136th out of

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116. Vienna Convention, *supra* note 43, art. 26.

117. *Id.* art. 27.

118. Internal Revenue Service, Claiming Tax Treaty Benefits, *available at* http://www.irs.gov/businesses/small/international/article/0,,id=96438,00.html (last accessed Feb. 19, 2012).

119. WORLD BANK & INTERNATIONAL FINANCE CORPORATION, DOING BUSINESS 2012: DOING BUSINESS IN A MORE TRANSPARENT WORLD (2011). *See also* Doing Business, About Doing Business, *available at*

183 countries or economies, which is a fall of two spots from the 2011 ranking. For comparison, the Philippines' ranking was considerably lower than its Southeast Asian neighbors: Thailand (17th), Malaysia (18th), Taiwan (25th), and Vietnam (98th), and was closest to Indonesia (129th).[120]

In this survey, "[e]conomies [were] ranked on their ease of doing business, from 1 [to] 183. A high ranking on the ease of doing business index means the regulatory environment is more conducive to the starting and operation of a local firm."[121] The ease of doing business rank is an average of each country's ranking on 10 topics,[122] including taxation. For taxation, which considers the rates of taxes and *complexity and burden of administrative tax rules* (covering the period January to December 2010), the Philippines ranked 136th, which is a drop of nine spots from the 2011 ranking.

By any rational standard, it can be concluded from this survey that the Philippines is not very attractive for businesses, including foreign investment, even when compared to other Southeast Asian countries. While tax treaty relief applications are admittedly only one strand of the complex web of

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http://www.doingbusiness.org/about-us (last accessed Feb. 19, 2012). The Doing Business Project aims to —

> [provide] objective measures of business regulations and their enforcement across 183 economies and selected cities at the subnational and regional level. The [Doing Business Project], launched in 2002, looks at domestic small and medium-size companies and measures the regulations applying to them through their life cycle. By gathering and analyzing comprehensive quantitative data to compare business regulation environments across economies and over time, [Doing Business] encourages countries to compete towards more efficient regulation; offers measurable benchmarks for reform; and serves as a resource for academics, journalists, private sector researchers and others interested in the business climate of each country. In addition, [Doing Business] offers detailed subnational reports, which exhaustively cover business regulation and reform in different cities and regions within a nation. These reports provide data on the ease of doing business, rank each location, and recommend reforms to improve performance in each of the indicator areas. Selected cities can compare their business regulations with other cities in the country or region and with the 183 economies that Doing Business has ranked.

Id.

120. Doing Business, Economy Rankings, *available at* http://www.doingbusiness.org/rankings (last accessed Feb. 19, 2012).

121. *Id.*

122. These topics are: (i) Starting a Business; (ii) Dealing with Construction Permits; (iii) Getting Electricity; (iv) Registering Property; (v) Getting Credit; (vi) Protecting Investors; (vii) Paying Taxes; (viii) Trading Across Borders; (ix) Enforcing Contracts; and (x) Resolving Insolvency. *Id.*

regulatory tax rules of the Philippines, it is a vital one. Its reform or rationalization would be a substantial step in the right direction towards economic development.