REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

INDUSTRIAL INSPECTION (INT'L.) INCORPORATED,
Petitioner,

- versus -

C.T.A. CASE NO. 5152

LIWAYWAY VINZONS CHATO in her capacity as The Commissioner of the Bureau of Internal Revenue,
Respondent.

Promulgated:

MAY 19 1997

x - x

D E C I S I O N

Before us is a petition for review of the decision of respondent Commissioner of Internal Revenue denying the Request for Reconsideration of a deficiency business tax (VAT) assessment amounting to ₱46,677.09 for the third and fourth quarter of 1989.

Petitioner is a VAT registered domestic corporation organized and existing under the Philippine laws. It is engaged in the practice of general engineering and contractorship services, specializing in radiographic inspection, ultrasonic thickness gaging, liquid penetrant testing and ultrasonic flow detection.

On September 28, 1992, petitioner received an Assessment Notice (Exh. G) with accompanying computations from the respondent, requiring it to pay the amount of ₱46,677.09 representing deficiency value added tax inclusive of surcharges, interests and compromise penalty for the third and fourth quarters of 1989. The assessment was computed as follows:

	3rd Qtr.	4th Qtr.
Gross receipts	₱3,181,738.10	₱2,604,819.40
Add: Disallowances	125,605.32	91,220.61
Total gross receipts per inv.	P3,307,337.42	P2,696,040.01
Tax due thereon	P 330,733.74	P 269,604.00
Less: Tax paid per return	(252,555.18)	(172,757.10)
Input tax	(65,618.03)	(87,724.84)
Deficiency business tax	P 12,560.53	P 9,122.06
Add: 25% surcharge	3,140.13	2,280.51
20% interest	8,775.74	5,798.12
Compromise penalty	3,000.00	2,000.00
Total Amount Due & Collectible	P 27,476.40	P 19,200.69

Petitioner traced the origin of the assessments as those coming from the disallowance of the services rendered for ALCORN PRODUCTION (PHILIPPINES), INC., and HYUNDAI ENGINEERING & CONSTRUCTION CO., LTD., which according to petitioner are exempt and effectively zero-rated transactions, respectively.

On October 28, 1992, petitioner filed a request for reconsideration with the following contentions: (pp. 220-225, BIR records)

1. The gross receipts from the services rendered as subcontractor to Hyundai Engineering & Construction Co., Ltd., a contractor engaged by Asian Development Bank (ADB) to construct the ADB Building, is tax exempt. We quote the explanation of petitioner, to wit:

> "When the Philippine Government and the Asian Development Bank agreed pursuant to Section 6 of the supplementary agreement dated December 28, 1984 and reiterated in paragraph 16 of the Memorandum of Understanding dated March 20, 1985, exempting all transactions related to the new ADB Bldg. Project from the payment of VAT, then this exemption must extend to the herein Protestor simply because as a subcontractor, it is performing its services in favor of the ADB upon the behest of Hyundai. Again to assess the Protestor of the value added tax pursuant to the contract it performed in favor of Hyundai and in the same vein exempt Hyundai from paying the same assessment is opposed to the equal protection clause of the Constitution." (p. 221, BIR record)

2. The gross receipts for services rendered for Alcorn Production (Phils.), Inc., an entity contracted by the Philippine Government to drill oil wells in strategic sites within the Philippine territory, is tax exempt. This position is anchored on VAT Ruling 516-88 (Exh. H, p. 167, CTA rec.), dated November 16, 1988, which in portion states that:

> "In reply, please be informed of the following:

> 1. By virtue of FIRB Resolution No. 19-87, PNOC Marine Corporation is exempt from VAT, and should not incorporate VAT on its billings to Alcorn (Production) Philippines, Inc. and to all other petroleum service contractors it transacts with."

The said exemption is based upon the Fiscal Incentives, dated June 24, 1987, restoring the tax and duty exemption to subcontractors and petroleum service contractors. The petitioner, submitting that it falls under the category of a subcontractor, is exempt from the payment of 10% VAT for services rendered for Alcorn Philippines.

On August 27, 1994, petitioner through counsel received the decision of the herein respondent, dated February 7, 1994, denying the request for reconsideration and reiterating her demand for the payment of the deficiency business tax (VAT). The pertinent portion of the decision is quoted hereunder, to wit:

> "In brief, hereunder is a rundown of your client's total receipts which this Bureau's examiner disallowed after investigation and for which reason has slapped thereto a deficiency tax of P46,677.09 inclusive of increments:

Name of Customer	Amount
1. From Alcorn Production (Phils.), Inc.	P 36,840.00
2. Hyundai Engineering & Construction Corporation	152,188.00
3. Economic Support Fund Secretariat	20,300.00

4. Vincotte International, Limited	125,191.68
Total Amount Disallowed	P334,519.68

Records of the case disclose that your client has not applied for nor obtained from the BIR an application for the imposition of "zero-rate" for the transactions under consideration.

After careful review of the facts of the case as well as the laws, rules and regulations applicable thereto, we come to conclude that your position cannot withstand the test of legal scrutiny for the following reasons:

1. Under Section 8 of Revenue Regulations 5-87, implementing the Value-Added Tax Law, it states: "Any person claiming that its sales of goods or services are effectively zero-rated under Sections 100 and 102 shall file an application in a form prescribed therefor with the Commissioner of Internal Revenue justifying the imposition of zero rate on the said transactions. Upon approval, his status as a zero-rated taxpayer shall remain valid until revoked."

2. This requirement has been notably reiterated in BIR Rulings 513-88 and 088-90, the facts of which bear striking semblance to your case, and we quote the identical dispositive portions thereof.

> "xxx In other words, billings by the seller of goods or services who executed the projects funded by ESF shall not include the value-added tax: Provided, however, that the seller of said goods or services shall first apply for zero rating in accordance with Section 9(b) of Revenue

Regulations No. 5-87". (Underscoring Supplied)

In the light of the foregoing, we sustain and reiterate the validity of the examiner's imposition re deficiency business tax liabilities (value-added tax) against your client, x x x.

This constitutes the final decision of this Bureau on the matter." (Exh. 4, pp. 266-267, BIR rec.)

The request for reconsideration having been denied by the respondent Commissioner, petitioner filed this case on September 26, 1994.

Based on the foregoing facts, we are obliged to focus ourselves with the issue of whether or not the petitioner is a tax exempt or a zero-rated taxpayer with regard to its gross receipts from the services rendered to Alcorn Production (Phils.), Inc., and Hyundai Engineering & Construction Co., Inc..

Sections 102(a)(3) and 103(u) of the Tax Code provide:

"Sec. 102. ***Value-added tax on sale of services.*** - (a) *Rate and base of tax.* - There shall be levied, assessed and collected, a value-added tax equivalent to 10% of gross receipts derived by any person engaged in the sale of services. x x x *Provided* That the following services performed in the Philippines by VAT-registered persons shall be subject to 0%:

x x x

> (3) Services rendered to persons or entities whose exemption under special laws or international agreements to which the Philippines is a signatory effectively subjects the supply of such services to zero rate."
>
> "Sec. 103. *Exempt Transactions.* - The following shall be exempt from the value-added tax:
>
> x x x
>
> (u) Transactions which are exempt under special laws or international agreements to which the Philippines is a signatory."

The Value-Added Tax implementing regulation, Revenue Regulations No. 5-87, under Sections 8(a), 8(c)(2), 8(d), 9(a) and 9(b)(16) provide the following:

> "Sec. 8. *Zero-rating.* - (a) *In general.* - A zero-rated sale is a taxable transaction for value-added tax purposes. A sale by a VAT-registered person of goods and/or services taxed at zero-rate shall not result in any output tax. The input tax on his purchases of goods and services related to such zero-rated sale shall be available as tax credit or refundable in accordance with Section 16 of these Regulations.
>
> x x x
>
> (c) *Zero-rated sales of services.* - The following services rendered by VAT-registered persons are zero-rated:
>
> x x x
>
> > (2) Services rendered to persons or entities which are effectively zero-rated under special laws or international agreements. In this case, if under the law or agreement, it is not only the entity that is exempt from taxes but also its suppliers, the sales of services to

such entity are effectively zero-rated. The example given above with respect to sale of goods to U.S. military facility and the Asian Development Bank shall also apply to those rendering services.

(d) *Application for the imposition of zero rate.* - Any person claiming that its sales of goods or services are effectively zero-rated under Sections 100 and 102 shall file an application in a form prescribed therefor with the Commissioner of Internal Revenue justifying the imposition of zero rate on the said transactions. Upon approval, his status as a zero-rated taxpayer shall remain valid until revoked."

"**Sec. 9** ***Exemptions.*** - (a) *In general.* - An exemption means that the sale of goods or services is not subject to value-added tax (output tax). The seller is not allowed any tax credit on VAT (input tax) previously paid. The person making the exempt sales of goods or services shall not separately bill any output tax to his customers because the said transaction is not subject to VAT.

x x x

(b) *Exempt transactions.* -

x x x

(16) Transactions which are exempt under special laws or international agreements to which the Philippines is a signatory."

Petitioner basically relied on the agreement entered into between the Philippine Government and the ADB per the "Memorandum of Understanding Between the Government of the Republic of the Philippines and the Asian Development Bank Regarding the Headquarters of the Asian

Development Bank", which states in part, under Section 16 Title IV thereof, that:

> "IV. PROCUREMENT
>
> 16. Pursuant to Section 6(a) of the Supplementary Agreement, all materials, equipment, fixtures, furnishings, supplies and services required for the Project (the Project Goods) are exempt from all taxes, custom duties and other levies. x x x." (Exh. E-1, p. 148, CTA record; Underscoring supplied.)

This Memorandum of Understanding, effective March 20, 1985, has been duly ratified by the late Pres. Ferdinand E. Marcos. (Exh. E, p. 137, CTA rec.)

Furthermore, petitioner pointed out that the Office of Energy Affairs issued OEA Circular No. 89-01-01 series of 1989, dated December 22, 1989, signed by W.R. Dela Paz, Executive Director, informing all petroleum service contractors and sub-contractors that the VAT Committee of the Bureau of Internal Revenue (BIR) had issued VAT Ruling No. 516-88, November 16, 1988, which ruled that:

> "Petroleum subcontractors are exempt from the payment of VAT from its gross receipts for services paid by the petroleum service contractors by virtue of the Fiscal Incentives Review Board (FIRB) resolution under FIRB Resolution No. 19-87 dated June 24, 1987, restoring the tax and duty exemption (including VAT) to subcontractors and petroleum service contractors subject however to the terms and condition of P.D. 1354." (p. 261, BIR records.)

We shall tackle each of the disallowance ruled by the respondent, to wit:

(1)	Alcorn Production (Phils.), Inc.	P 36,840.00
(2)	Hyundai Engineering & Construction Corporation	152,188.00
(3)	Economic Support Fund Secretariat	20,300.00
(4)	Vincotte International, Limited	125,191.68
	T O T A L	P334,519.68

(1) ALCORN PRODUCTION (PHILS.), INC. - P36,840.00

With respect to the services rendered for Alcorn Production (Phils.), Inc., this Court agrees with the petitioner. Therefore, the decision of respondent disallowing the receipts amounting to P36,840.00 is incorrect.

Section 1 of P.D. 1354 [Imposing Final Income Tax on Subcontractors and Alien Employees of Service Contractors and Subcontractors Engaged in Petroleum Operations in the Philippines under Presidential Decree No. 87], April 21, 1978, provides:

> "SECTION 1. *Tax on subcontractors.* - Every subcontractor, whether domestic or foreign, entering into a contract with a service contractor engaged in petroleum operations in the Philippines shall be liable to a final income tax equivalent to eight

> percent (8%) of its gross income derived from such contract, <u>such tax to be in lieu of any and all taxes, whether national or local</u>: x x x." (Underscoring supplied.)

Petitioner, as subcontractor of Alcorn Production (Phils.), Inc., an entity engaged in petroleum operations in the Philippines, is already subject to the 8% final income tax. Therefore, this tax shall be paid in lieu of all taxes (including the VAT) pursuant to P.D. 1354. This was strengthened by VAT Ruling No. 516-88, November 16, 1988 (Exh. H, pp. 166-167, CTA record) and OEA Circular No. 80-01-01, December 22, 1989, (p. 261, BIR record) holding that petroleum subcontractors are exempt from the payment of the VAT from its gross receipts for services paid by the petroleum service contractors.

In all aspect, petitioner should not be held liable for the VAT for services rendered to Alcorn, being a contractor engaged in petroleum operations in the Philippines.

(2) HYUNDAI ENGINEERING & CONSTRUCTION CO., LTD. - P152,188.00

Based on the Ratified Memorandum of Understanding (Exh. E), entered into between Asian Development Bank and the Philippine Government, the procurement of supplies and <u>services</u> required for the project (which is the development of a new headquarters building for the bank) are exempt from all taxes, customs duties and other levies.

In addition, Section 8(c)(2) of Rev. Regs. No. 5-87, explicitly provides that the sale of goods and services to the Asian Development Bank shall be considered effectively zero-rated under special laws. However, there is a hitch. Section 8(d) of the said regulation also provides for an additional requirement, that is, the need to file an application with the Commissioner of Internal Revenue justifying the imposition of zero-rate on the said transactions.

In the case at bar, petitioner failed to file the required application needed to be entitled to a zero-rate VAT. A close scrutiny of the BIR records would reveal that petitioner has not proven by documentary evidence that indeed it has applied for a zero-rate on this kind of transaction with Hyundai Engineering and Construction Co., Ltd.. Therefore, the gross receipts from Hyundai Engineering and Construction Co., Ltd. should be subject to the VAT.

(3) ECONOMIC SUPPORT FUND SECRETARIAT - P20,300.00 and

(4) VINCOTTE INTERNATIONAL, LTD. - P125,191.68

The disallowances on the gross receipts from the Economic Support Fund Secretariat and Vincotte

International, Ltd. remain to be valid, there being no evidence presented by petitioner to support its protest on these disallowances. The same is therefore presumptively correct (**Fed. Tax Practice, par 8-6, p. 201; Coll. v. Bohol Land Transp. Co., GR L-13099, April 29, 1960**).

Per this Court's computation, the deficiency business tax (VAT) liability of the petitioner should be as follows:

	3rd Qtr.	4th Qtr.
Gross receipts	P3,181,738.10	P2,604,819.40
Add: Disallowances	90,765.30	89,220.60
Total gross receipts per inv.	P3,272,503.40	P2,694,040.00
Tax due thereon	P 327,250.34	P 269,404.00
Less: Tax paid per return	(252,555.18)	(172,757.10)
Input tax	(65,618.03)	(87,724.84)
Deficiency business tax	P 9,077.13	P 8,922.06
Add: 25% surcharge	2,269.28	2,230.51
Total Amount Due & Collectible	P 11,346.41	P 11,152.57

Compromise penalty should not imposed due to the absence of an agreement freely entered into between petitioner and respondent (**Collector of Internal Revenue v. UST, GR L-11274 & L-11280, Nov. 28, 1958; M.R. Arick v. Comm., CTA 1679, May 30, 1969**).

WHEREFORE, in view of all the foregoing, the decision of respondent, dated February 7, 1994, is hereby

DECISION -
C.T.A. CASE NO. 5152

MODIFIED. The petitioner is hereby directed to pay the respondent the amount of P22,498.98, representing deficiency busines (value-added) tax inclusive of surcharge for the third and fourth quarters of 1989, plus 20% interest per annum from the date prescribed for payment until its full payment pursuant to Section 249 of the National Internal Revenue Code.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

RAMON O. DE VEYRA
Associate Judge

AMANCIO Q. SAGA
Associate Judge

CERTIFICATION

I hereby certify that this decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals