REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

DONALD L. SMITH,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 6455

Promulgated:

JUN 2 7 2003

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DECISION

This is a judicial claim for refund of One Million Five Hundred Seventy Eight Thousand Three Hundred Eighty Three Pesos and Forty One Centavos (P1,578,383.41) allegedly representing petitioner's erroneously paid income tax for the taxable year 2000.

The antecedent facts of the case are as follows:

Petitioner is a citizen of the United States, of legal age, married and is an employee of the Coastal Subic Bay Terminal Inc., with address at 42 A Grayling Street, West Kalayaan, Subic Bay Freeport Zone, Philippines. In the year 2000, he was employed as controller of the Coastal Subic Bay Terminal, Inc., a business entity located in and registered with the Subic Special Economic Zone as created by Republic Act No. 7227. Petitioner was issued Tax Identification No. 170-302-240 by the Bureau of Internal Revenue *(pars. 3,4, and 5 Joint Stipulation of Facts and Issues).*

On April 18, 2001, petitioner filed his Annual Income Tax Return for the taxable year 2000 and paid P1,578,383.41 income tax for the income he derived from his employment with the Coastal Subic Bay Terminal Inc. *(Annexes A and B, Petition for Review).*

Believing that he erroneously paid his income tax, petitioner filed his written claim for refund on April 16, 2002 with the Bureau of Internal Revenue (*par. 7 Joint Stipulation of Facts and Issues).* Unable to obtain immediate action from the respondent, petitioner elevated the case to this court through a Petition for Review on April 17, 2002.

On April 23, 2002, summons was issued to respondent through personal delivery. Due to respondent's failure to file his Answer within the period prescribed by the court and due to petitioner's failure to prosecute the case for an unreasonable length of time, the court issued a Resolution dated June 25, 2002 dismissing the case without prejudice pursuant to Section 3, Rule 17 of the Rules of Court.

On June 28, 2002 respondent filed his Motion to Admit Answer and alleged therein that his failure to file his Answer was due to inadvertence and without the least intention to delay the disposition of the case.

Petitioner, on July 10, 2002, filed an Omnibus Motion (For Reconsideration and To Set the Case for Pre- trial Ad Cautelam). During the hearing on August 16, 2002, the court granted petitioner's Omnibus Motion and respondent's Motion to Admit Answer.

In his Answer, respondent raised the following as Special and Affirmative Defenses, thus:

> 4. Petitioner's alleged claim for refund is still subject to administrative routinary investigation/examination by respondent's Bureau.

5. Sec. 12(c) of R.A. 7227, otherwise known as the "Bases Conversion and Development Act of 1992", relied upon by the petitioner in claiming the refund provides:

> "SEC. 12. Subic Special Economic Zones.- xxx
>
> (c) The provision of existing laws, rules and regulations to the contrary notwithstanding, no taxes, local and national, shall be imposed within the Subic Special Economic Zone. **In lieu of paying taxes, three percent (3%) of the gross income earned by all businesses and enterprises within the Subic Special Economic Zone shall be remitted to the National Government,** one percent (1%) each to the local government units affected by the declaration of the zone in proportion to their population area, and other factors. In addition, there is hereby established a development fund of one percent (1%) of the gross income earned by all businesses and enterprises within the Subic Special Economic Zone to be utilized for the development of municipalities outside the City of Olongapo and the Municipality of Subic, and other municipalities contiguous to the base areas.
>
> In case of conflict between national and local laws with respect to tax exemption privileges in the Subic Special Economic Zone, the same shall be resolved in favor of the latter. (Emphasis supplied)

Under the foregoing provisions, only business establishments operating within the Subic Special Economic Zone are exempt from national and local taxes. Petitioner is not covered by the exemption privilege granted under Section 12 (c) of Republic Act No. 7227, as implemented by Section 4 of Revenue Regulations No. 1-95.

6. Petitioner's claim for refund lacks any basis in law.

7. In an action for refund/credit, the burden of proof is upon the taxpayer to establish its right to refund and failure to sustain the burden is fatal to the action for refund.

On October 4, 2002 the case was set for pre-trial and during the hearing, the parties moved to submit the case for decision based on pleadings since the issues for resolution are purely legal. The court granted the motion.

The issues for this court's determination have been jointly stipulated by the parties to be as follows:

1. Whether or not aliens working within the Subic Special Economic Zone are subject to Philippine income taxes on income earned from such employment.

2. Whether or not petitioner is entitled to a refund or tax credit for income taxes paid on compensation earned from working within the Subic Special Economic Zone.

The central controversy the court is called upon to resolve lies in the interpretation of the parties on Section 12(c) of Republic Act 7227, otherwise known as the Bases Conversion and Development Authority Act of 1992. The said provision is hereunder quoted for easy reference, thus:

> **SEC. 12.** ***Subic Special Economic Zone.*** - xxx
>
> (c) The provision of existing laws, rules and regulations to the contrary notwithstanding, no taxes, local and national, shall be imposed within the Subic Special Economic Zone. In lieu of paying taxes, three percent (3%) of the gross income earned by all businesses and enterprises within the Subic Special Economic Zone shall be remitted to the National Government, one percent (1%) each to the local government units affected by the declaration of the zone in proportion to their population area, and other factors. In addition, there is hereby established a development fund of one percent (1%) of the gross income earned by all businesses and enterprises within the Subic Special Economic Zone to be utilized for the development of municipalities outside the City of Olongapo and the Municipality of Subic, and other municipalities contiguous to the base areas.
>
> In case of conflict between national and local laws with respect to tax exemption privileges in the Subic Special Economic Zone, the same shall be resolved in favor of the latter.

Petitioner argued that he is entitled to a refund of his alleged erroneously paid income tax for the taxable year 2000 based on the above provision, which according to him, provides the tax exemption privilege. As stated in the opening statement:

> "The provision of existing laws, rules and regulations to the contrary notwithstanding, no taxes, local and national, shall be imposed within the Subic Special Economic Zone."

According to petitioner, the use of the phrases *"within the Subic Special Economic Zone"* and *"the provision of existing laws, rules and regulations to the contrary notwithstanding"* means that the tax exemption extends to everything and everyone inside the Subic Special Economic Zone, without any exception or qualification; hence individual taxpayer, like petitioner, is within the purview of the tax exemption. As a substitute for paying taxes, businesses and enterprises within the SSEZ should remit a total of 5% of its gross income. Thus, the subsequent proviso reads *"in lieu of paying taxes, 3% of the gross income earned by all business and enterprises within the SSEZ shall be remitted to the National Government, one percent (1%) each to the local government units affected by the declaration of the zone in proportion to their population area, and other factors."*

Petitioner also advanced the argument that the law provides categorically in the final paragraph that in case of conflict between national and local laws with respect to tax exemption privileges in the Subic Special Economic Zone, the same shall be resolved in favor of the latter.

Respondent, however, does not agree with petitioner's interpretation. He counter-argued that there is no specific provision in R.A. 7227 which exempts employees within the Subic Special Economic Zone from the payment of income tax. Moreover, according to respondent, Revenue Regulations No. 1-95, particularly Sections 4 and 6, which implement the tax incentive provisions under paragraphs (b) and (c) of Section 12, Republic Act No. 7227, state that only registered enterprises doing trade or business within the SSEZ are covered by the exemption privilege. Petitioner, not being a registered enterprise doing trade or business, is, therefore, not covered.

After a circumspect reading of the provisions of law relied upon by the parties, we find the instant petition for review unmeritorious.

First, we cannot subscribe to petitioner's view that the phrases "*within the Subic Special Economic Zone*" and "*the provision of existing laws, rules and regulations to the contrary notwithstanding*" mean exemption from taxation without qualification. We observe that petitioner, in interpreting the said provision, has isolated those phrases from the other parts of the provision and failed to construe said provision in consonance with the true legislative intent. The court adheres to the well-entrenched rule in statutory construction that the best source from which to ascertain legislative intent is the statute itself - the words, phrases, sentences, sections, clauses, provisions - taken as a whole and in relation to one another. In ascertaining the legislative intent the whole context of the statute and not from an isolated part or particular provision should be considered. The context may circumscribe the meaning of the statute; it may give to a word or phrase a meaning different from its usual or ordinary signification. In such a case, the meaning dictated by the context prevails *(Agpalo, Statutory Construction, 3rd ed., p.61)*. Thus, the sentence "*The provision of existing laws, rules and regulations to the contrary notwithstanding, no taxes, local and national, shall be imposed within the SSEZ*" must be read together with the following sentence "*In lieu of paying taxes, 3% of the gross income earned by all businesses and enterprises within the SSEZ shall be remitted to the National Government, one percent (1%) each to the local government units affected by the declaration of the zone in proportion to their population area, and other factors. In addition, there is hereby established a development fund of one percent (1%) of the gross income earned by all businesses and enterprises within the Subic Special Economic Zone to be utilized for the development of the municipalities outside the City of Olongapo and the Municipality of Subic, and other municipalities contiguous to the base areas.*" This phrase belies petitioner's assertion that SSEZ is indeed a tax-free territory. The term "in lieu of paying taxes" as used in the law does not constitute an absolute exemption from taxation. While spared from national and local taxes, businesses and enterprises within the SSEZ are subjected to the said tax base on gross income. No matter what legal jargon is used, the said taxes are in fact taxes imposed on businesses or enterprises operating within the SSEZ. Thus, it is incorrect to say that SSEZ is actually a tax-free territory (***Donald L. Smith vs. Commissioner of Internal Revenue, CTA Case No. 6268, September 12, 2002***).

Moreover, in the case of ***Cotero vs. Commissioner of Internal Revenue, CTA Case No. 6267, promulgated on September 12, 2002*** which involves the same issue, the court citing the case of *Tiu vs. Court of Appeals, 301 SCRA 278*, declared, thus:

> "To better appreciate the law, it is important to delve on the reasons for its creation. Republic Act No. 7227 was created to accelerate the sound and balanced conversion of military reservations into other productive uses, to raise funds by the sale of portions of Metro Manila military camps, and to apply said funds as provided herein for the productive civilian use of the lands covered under the 1947 Military Bases

Agreement between the Philippines and the United States of America, as amended. Under its Declaration of Policies, it is so provided that:

> "It is likewise the declared policy of the Government to enhance the benefits to be derived from said properties <u>in order to promote the economic and social development of Central Luzon in particular and the country in general</u>." (Emphasis ours.)

Indubitably, the prime objective of the law is to attract and encourage investors to promote economic and social growth. As elucidated by the Supreme Court in one case:

> "From the above provisions of the law, it can easily be deduced that the real concern of RA 7227 is to convert the lands formerly occupied by the US military bases into economic and industrial areas. In furtherance of such objective, Congress deemed it necessary to extend economic incentives to attract and encourage investors, both local and foreign. Among such enticements are: (1) a separate customs territory within the zone, (2) tax-and-duty-free importations, (3) restructured income tax rates on business enterprises within the zone, (4) no foreign exchange control, (5) liberalized regulations on banking and finance, and (6) the grant of resident status to certain investors and of working visas to certain foreign executives and workers."

It is noteworthy that except for the privilege of granting working visas, the law is silent as regards their taxability. This goes without saying that the provisions of the Tax Code, as amended, apply. Under Section 23(D) of the 1997 Tax Code, "an alien individual, whether a resident or not of the Philippines, is taxable only on income derived from sources within the Philippines."

Clearly, if we adopt petitioner's interpretation of the provision, it would in effect be inconsistent with the legislative intent, which was elucidated above.

Second, we agree with respondent that the tax incentive provided in Section 12(c) of R.A. 7227 refers only to registered businesses and enterprises within the Subic Special Economic Zone pursuant to Sections 4 and 6 of Revenue Regulations 1-95. Indeed, the revenue regulation which implements Section 12 (b) and (c) of R.A. 7227 categorically mentions that tax incentives shall be enjoyed by all SMBA registered enterprises doing business within the secured area in the zone. We opine that the rules promulgated pursuant to law are binding on the courts, even if they are not in agreement with the policy stated therein or within its innate wisdom *(Agpalo, Statutory Construction, 3rd ed., p.18)*.

Finally, while we agree with petitioner that Section 12(c) categorically provides that in case of conflict between national and local laws with respect to tax exemption privileges in the Subic Special Economic Zone, the same shall be resolved in favor of the latter, we find the same not applicable to the case at bar. There is no conflicting national or local laws regarding tax incentives affecting individual taxpayers like herein petitioner. We reiterate, the court believes that the tax incentive provided under the above mentioned law refers only to registered businesses and enterprises within the Subic Special Economic Zone and not to individual taxpayers.

IN THE LIGHT OF THE FOREGOING, the instant Petition for Review is hereby **DENIED** for lack of merit.

SO ORDERED.

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

LOVELL R. BAUTISTA
Associate Judge

C E R T I F I C A T I O N

I hereby certify that the above 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