**REPUBLIC OF THE PHILIPPINES**
**COURT OF TAX APPEALS**
**QUEZON CITY**

**SECOND DIVISION**

**ZMG WARD HOWELL, INC.,**
*Petitioner,*

- versus -

**COMMISSIONER OF INTERNAL REVENUE,**
*Respondent.*

**CTA Case No. 9004**

Members:

**CASTAÑEDA, JR.,** *Chairperson,*
**CASANOVA,** and
**MANAHAN,** *JJ.*

Promulgated:

SEP 18 2017

9:50 a.m.

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# DECISION

**CASTAÑEDA, JR., *J.:***

## THE CASE

This is a Petition for Review[1] filed by petitioner ZMG Ward Howell, Inc. on March 4, 2015, pursuant to Section 228 of the National Internal Revenue Code of 1997, as amended (1997 NIRC) in relation to Section 11 of Republic Act (RA) No. 1125, as amended by RA No. 9282, praying that judgment be rendered ordering the cancellation and setting aside of respondent Commissioner of Internal Revenue's assessment for alleged deficiency value-added tax (VAT) for the period January 1, 2012 to June 30, 2012 inclusive of

[1] Petition for Review, Docket, Vol. I, pp. 7-17.

interest, in the aggregate amount of THREE MILLION NINE HUNDRED EIGHTY ONE THOUSAND THREE HUNDRED THIRTY ONE AND 99/100 PESOS (₱3,981,331.99).

## THE FACTS

Petitioner ZMG Ward Howell, Inc. is a corporation duly organized and existing under the laws of the Republic of the Philippines with principal place of business at the 5th Floor, The Athenaeum Building, 160 Leviste [formerly Alfaro] Street, Salcedo Village, Makati City, Metro Manila.[2] Petitioner was incorporated with the following primary purpose:

> "To act as managers or managing agents of persons, firms, associations, corporations, partnerships and other entities; to provide management, investment and technical advice for commercial, industrial, manufacturing and other kinds of enterprises; and to undertake, carry on, assist or participate in the promotion, organization, management, liquidation or reorganization of corporations, partnerships and other entities, except the management of funds, securities, portfolio or similar assets of the managed entities or corporations."[3]

On the other hand, respondent is the duly appointed Commissioner of Internal Revenue (CIR), vested under the appropriate laws with the authority to carry out the functions, duties, and responsibilities of said office including, *inter alia*, the power to issue assessments, decide disputed assessments, and cancel and abate tax liabilities, pursuant to the provisions of the 1997 NIRC, and other tax laws, rules, and regulations.[4]

On March 19, 2013, petitioner received the Preliminary Assessment Notice (PAN) dated March 19, 2013 from the Assessment Division – VAT Audit Team of the Bureau of Internal Revenue (BIR) Revenue Region No. 8 – Makati covering the alleged deficiency VAT for the period January 1, 2012 to June 30, 2012 in the amount of Php4,377,195.51.[5] ge

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[2] Par. 1, Stipulation of Facts, Joint Stipulation of Facts and Issues (JSFI), Docket, Vol. II, p. 830.
[3] Exhibit "P-1".
[4] Par. 2, Stipulation of Facts, JSFI, Docket, Vol. II, p. 830.
[5] Exhibit "P-3".

On April 3, 2013, petitioner filed its written Reply to the PAN with the Assessment Division – VAT Audit Team of BIR Revenue Region No. 8.[6]

On July 17, 2014, petitioner received a copy of the Final Assessment Notice (FAN) dated July 15, 2014 from the Assessment Division – VAT Audit Team of BIR Revenue Region No. 8 for alleged deficiency VAT for the period January 1, 2012 to June 30, 2012 in the amount of Php3,805,429.85.[7]

On August 15, 2014, petitioner filed its Protest Letter against the FAN with the Assessment Division – VAT Audit Team of BIR Revenue Region No. 8.[8]

On February 2, 2015, petitioner received the Final Decision on Disputed Assessment (FDDA) dated January 30, 2015 issued by the BIR Revenue Region No. 8 ordering petitioner to pay its alleged deficiency VAT for the period January 1, 2012 to June 30, 2012 in the total amount of PHp3,981,331.99, inclusive of interest, computed as follows:[9]

| | | | | |
|---|---|---|---|---|
| **VALUE-ADDED TAX** | | | | |
| VATable receipts per VAT returns | | | | P38,001,329.54 |
| Add: | Gross Receipts not subjected to VAT | | P2,252.29 | |
| | Unqualified Zero-rated Sale of Services | | 21,764,368.89 | 21,766,621.18 |
| Gross Receipts subject to VAT | | | | P59,767,950.72 |
| Output tax due | | | | P7,172,154.09 |
| Less: | Creditable input tax | | | |
| | Input Tax on Current Purchases | | P2,754,636.46 | |
| | Input Tax carried over from Previous Quarter | | 112,206.47 | |
| | Total Input Tax claimed per VAT Returns | | P2,866,842.93 | |
| | Less: Overclaimed Input Tax | P24,924.87 | | |

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[6] Exhibit "P-4".
[7] Exhibit "P-6".
[8] Par. 6, Stipulation of Facts, JSFI, Docket, Vol. II, p. 831.
[9] Par. 7, Stipulation of Facts, JSFI, Docket, Vol. II, pp. 831-832.

| | | | |
|---|---|---|---|
| Input Tax Carried over to Succeeding Quarter | 26,339.21 | 51,264.08 | 2,815,578.85 |
| VAT Payable | | | P4,356,575.24 |
| Less: Tax payments | | | 1,719,656.00 |
| Basic Tax Due | | | P2,636,919.24 |
| Less: Basic tax paid per re[tur]n | | | 25,154.01 |
| Remaining Basic VAT deficiency | | | P2,611,765.23 |
| Add: Interest (07.26.12 to 03.09.15) | | | 1,369,566.76 |
| **Total Amount Due** | | | **P3,981,331.99** |

On March 4, 2015, petitioner filed the present Petition for Review.

On April 25, 2015, respondent filed her Answer[10] wherein she interposed the following Special and Affirmative Defenses:

"**SPECIAL AND AFFIRMATIVE DEFENSES**

4. She reiterates and repleads the preceding paragraphs of this [A]nswer as part of her Special and Affirmative Defenses.

5. Petitioner was assessed for deficiency value-added tax (VAT) for taxable period covering January 1, 2012 to June 30, 2012, for the reason that during the administrative investigation of its tax case by the respondent CIR, petitioner failed to substantiate or controvert by substantial evidence the BIR factual findings, as stated and shown under the Details of Discrepancies attached to the Preliminary Assessment Notice (PAN) dated March 19, 2013 and Formal Assessment Notice (FAN) and Letter of Demand dated July 15, 2014, as well as, the Details of Discrepancies attached to the Final Decision on Disputed Assessment (FDDA) dated January 30, 2015, which are briefly discussed hereunder, viz:

a.) Petitioner was found to have understated its gross receipt not subjected to VAT in the amount of Php2,252.29 for taxable period covering Je

[10] Docket, Vol. I, pp. 84-89.

January 1, 2012 to June 30, 2012 as reflected in the computerized matching conducted by the BIR on the information/data provided by its customers (i.e. Geisermaclang Marketing Communications, Inc. and Merck Sharp Dohme La) against the total receipts declared in its VAT returns;

b.) Petitioner was found that (sic) as an executive search firm engaged to search for senior and mid-level executives in various industries, petitioner conducts its applicants' testing and interviews within its office premises and/or some private hotels and restaurants within Metro Manila and not within any ECOZONE. Moreover, petitioner's sale of services was found to have (sic) mainly consist of placing candidates and sending warm bodies for (sic) the clients to choose the qualified executives and right people for the jobs. The sending of pre-qualified applicants to the clients is a kind of service activity which is not directly involved in the manufacture, assembly or production of the final goods or services of petitioner, and the services being provided by petitioner do not directly vary with the changes in revenue or some other measure of the registered activities of the PEZA-registered entities. Accordingly, such sale of services of petitioner in the amount of Php21,764,368.89 for the taxable period covering January 1, 2012 to June 30, 2012 are unqualified as zero-rated VAT, and thus, assessed and subjected to 12% VAT under Section 108(A) of the 1997 Tax Code, following the BIR Ruling No. DA-202-08 dated March 28, 2008, which held that:

> 'From the foregoing, it is evident that sales of services by VAT-registered entities from the Customs Territory to PEZA-registered enterprises are entitled to avail of effective VAT zero-rating. The basis of VAT zero-rating is the fact that under R.A. 7916, as amended (PEZA Law), ECOZONEs are declared as separate customs territories which by legal fiction are considered foreign

soil. In BIR Ruling No. DA-344-2003 dated October 7, 2003, this Office held that the special tax incentives only apply with respect to the registered enterprise's operations within the ECOZONE. The Philippine VAT System is premised on 'destination principle', thus, imports are subject to VAT and exports are free of VAT. Where the supplier of services is a VAT-registered taxpayer, sale of services to a PEZA-registered enterprises (sic) shall be subject to VAT at zero percent (0%), provided that the services are rendered within the ECOZONE, and provided further, that the services are rendered in connection with the registered activity/ies of the buyers, i.e., PEZA-registered entities. Conversely, if the service is rendered within the customs territory, such sale of service by a VAT-registered person shall be subject to the 12% VAT irrespective of the status of the buyer as ECOZONE registered enterprise.

This is in consideration that (sic) the situs of VAT for sale of services is the place where the service is rendered. Thus, where the service by a VAT-registered person from customs territory is rendered within the ECOZONE, such sale of service shall effectively be subject to zero percent (0%) VAT.

It is clear from the foregoing then that even if Peninsula Manila's clients are PEZA-registered enterprises, in order to avail of VAT zero-rating, the services rendered to such clients should be made with respect to their operations within the Ecozone. In the present case, the food and accommodation services which Peninsula Manila renders to its PEZA-registered clients are made at the former's premises in Makati City and not within any Ecozone. Thus, there is no basis for the aforementioned clients to claim that such services are entitled to VAT zero-rating and accordingly, these services are subject to 12% VAT under Section 108 (A) of the Tax Code of 1997, as amended by R.A. 9337.'

c.) Petitioner was found to have overclaimed its input VAT in the amount of Php24,924.87 for taxable period covering January 1, 2012 to June 30, 2012 as reflected in the computerized matching conducted by the BIR on the information/data provided by its customers (i.e. Assessment Analytics, Inc., Brothers Venture Trading Corp., and Saringan Hernan Dela Cruz) against the total purchases declared in its VAT returns;

d.) Petitioner was found to have an excess input tax on capital goods exceeding P1Million carried over to the succeeding period/years in the total amount of P26,339.21, and the same was deducted from the total tax credit since the same shall be carried over and credited against the output tax due of the succeeding quarters/years pursuant to Section 110 (B) of the NIRC of 1997.

6. Respondent fully complied with the due process requirements mandated under Section 228 of the 1997 Tax Code, as implemented by Revenue Regulations No. 12-99, when the Preliminary Assessment Notice (PAN) dated March 19, 2013, Formal Assessment Notice (FAN) and Letter of Demand dated July 15, 2014, as well as, the Final Decision on Disputed Assessment (FDDA) dated January 30, 2015 were issued to herein petitioner. Records clearly show that petitioner was duly afforded an opportunity to controvert the factual findings of the respondent CIR involving its deficiency VAT for taxable period covering January 1, 2012 to June 30, 2012, and was duly appraised by the respondent of the factual and legal basis on how and why she (respondent) arrived [at] such as deficiency value-added tax assessment through the issuance of the Details of Discrepancies attached to the said Formal Assessment Notice (FAN) and Letter of Demand, Preliminary Assessment Notice (PAN), Notice of

Informal Conference, as well as the Final Decision on Disputed Assessment (FDDA). In fact, records clearly show that petitioner was able to file a letter protest against the said PAN and FAN.

7. This Honorable Court in the case of **IDS LOGISTICS (PHILS.), INC., vs. CIR, C.T.A. CASE NO. 7540. May 20, 2010**, citing the ruling in **Bank of the Philippine Islands vs. Commissioner of Internal Revenue, C.T.A. CASE NO. 7397, April 9, 2008**, thoroughly discussed the ***due process rule in taxation***, as follows:

> 'Revenue Regulations No. 12-85 provides for the procedure covering the Administrative Protests on Assessments of the BIR. Under the said Revenue Regulation, a post-reporting notice is sent to the taxpayer for an informal conference when there are findings of deficiency taxes. Subsequent to this notice is the issuance of the pre-assessment notice upon findings of the Commissioner that an assessment for deficiency taxes should be issued. However, such pre-assessment notice may or may not be protested by the taxpayer. In fact, Section 5 of the same Revenue Regulation provides that 'In the event that the taxpayer fails to respond to the pre-assessment notice within the prescribed period. . . he should be informed of such fact and the report of investigation shall be given due course.'
>
> The essential elements of due process are notice and opportunity to present one's side. To begin with, petitioner had knowledge of the investigation being conducted by the BIR on its tax liabilities for the taxable years 1982-1986, as evidenced by the letter of respondent addressed to petitioner dated September 25, 1986 and received by petitioner on September 26, 1986. The said letter, in fact, requested for an informal conference on the matter and requested further that petitioner submits documentary evidence to support its stand. Jr

As the facts would demonstrate, **petitioner was never deprived of due process as it was fully appraised of the legal and factual bases of the assessment issued against it; which enabled petitioner to substantially protest the arguments and issues raised. It is sufficient that there is notice to the taxpayer of the legal and factual bases of the assessment; and to the Court, this is substantial compliance of what is mandated by Section 228 of the NIRC. Thus, so long as the parties are given the opportunity to explain their side, the requirements of due process are satisfactorily complied with**.' (Emphasis supplied)

8. The assessments issued against petitioner for deficiency value-added tax (VAT) for taxable period covering January 1, 2012 to June 30, 2012 was made in accordance with law and regulations.

9. The deficiency VAT assessments issued by the respondent CIR to herein petitioner is prima facie presumed correct and made in good faith. Petitioner has the duty of proving otherwise. In the absence of proof of any irregularities in the performance of official duties, the said VAT assessment will not be disturbed. Hence, all presumptions are in favor of the correctness of the subject tax assessment issued by the respondent. *(Interprovincial Autobus Co., Inc. vs. Collector of Internal Revenue, 98 Phil. 290; Sy Po vs. CTA, G.R. No. 81446, August 18, 1988; Dayrit, vs. Cruz, L-39910, September 26, 1988; Cagayan Robina Sugar Milling Co., vs. CA, G.R. No. 122451, October 12, 2000). Failure to present proof of error in the assessment will justify judicial affirmation of said assessment (Delta Motors Co., vs. CIR, CAT (sic) Case No. 3782, May 21, 1986; CIR vs. CA, G.R. Nos. 104151 and 105563, March 10, 1995)*."

The Pre-Trial Conference[11] was held on July 23, 2015. Petitioner's Pre-Trial Brief[12] was filed on June 22, 2015 while

[11] Minutes of the Hearing dated July 23, 2015, Docket, Vol. II, p. 824.
[12] Docket, Vol. I, pp. 96-113.

respondent's Pre-Trial Brief[13] was filed on July 15, 2015. On July 16, 2015, petitioner filed its Amended Pre-Trial Brief.[14]

The parties filed their Joint Stipulation of Facts and Issues[15] on August 12, 2015, which was approved by the Court upon issuance of the Pre-Trial Order[16] on August 20, 2015.

During trial, petitioner presented its lone witness, Mr. Hernan C. Saringan[17] – petitioner's Vice-President for Finance and Admin.

On October 12, 2015, petitioner filed its Formal Offer of Evidence (FOE).[18] Respondent failed to file Comment on petitioner's FOE as per the Records Verification Report issued by this Court's Judicial Records Division dated January 12, 2016.[19]

On March 1, 2016, the Court issued a Resolution[20] admitting as petitioner's evidence all of the documentary exhibits offered in petitioner's FOE dated October 12, 2015.

On the other hand, respondent presented the following witnesses: (1) Mr. Renan A. Plata[21] – Group Supervisor, Revenue Region No. 8; and (2) Ms. Pauline Lydia M. Reyes[22] – Revenue Officer, Revenue Region No. 8.

Respondent filed her Formal Offer of Evidence[23] via registered mail on May 13, 2016 while petitioner's Comment (To Respondent's Formal Offer of Evidence)[24] was filed on May 30, 2016. In a Resolution[25] dated July 22, 2016, this Court admitted Exhibits "R-2", "R-2-b", "R-3", "R-3-a", "R-3-b", "R-4", "R-4-a", "R-4-b", "R-4-c", "R-5", "R-5-a", "R-5-b", "R-6", "R-6-a" of respondent's FOE. However, this Court denied Exhibit "R-1" for failure to submit the duly marked exhibit. In the same Resolution, the Court ordered the parties to file

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[13] Docket, Vol. II, pp. 587-590.
[14] *Id.*, pp. 591-608.
[15] Docket, Vol. II, pp. 830-847.
[16] *Id.*, pp. 849-852.
[17] Minutes of the Hearing dated September 9, 2015, Docket, Vol. II, p. 869.
[18] Docket, Vol. II, pp. 878-897.
[19] *Id.*, p. 1086.
[20] *Id.*, pp. 1088-1089.
[21] Minutes of the Hearing dated April 18, 2016, Docket, Vol. II, p. 1090.
[22] *Id.*
[23] Docket, Vol. II, pp. 1094-1097.
[24] *Id.*, pp. 1099-1103.
[25] *Id.*, pp. 1105-1106.

their Memoranda within a period of thirty (30) days from receipt thereof.

On October 10, 2016, petitioner filed its Memorandum.[26] On the other hand, respondent filed on September 7, 2016 a Manifestation and Motion for Leave[27] stating that she is adopting all factual and legal arguments raised in her Answer as well as documentary and testimonial evidence found in the case records as her Memorandum. This Court noted and granted the said Manifestation and Motion for Leave in a Resolution[28] dated September 16, 2016. Accordingly, the case was declared submitted for decision on October 13, 2016.[29]

## THE ISSUES

The parties submitted the issues[30] stated below for the Court's resolution:

**A. WHETHER OR NOT PETITIONER'S SALES OF SERVICES QUALIFY AS ZERO-RATED SALES.**

**B. WHETHER OR NOT SALES OF SERVICES TO PEZA-REGISTERED ENTERPRISES SHOULD BE RENDERED WITHIN THE ECOZONE AND BE DIRECTLY CONNECTED TO THE ACTIVITY/IES OF PEZA-REGISTERED ENTERPRISES TO BE COVERED BY VAT-ZERO RATING.**

**C. WHETHER OR NOT PETITIONER IS LIABLE FOR DEFICIENCY VAT ON ITS SALE OF SERVICES IN THE AMOUNT OF PHP3,981,331.99 (INCLUSIVE OF SURCHARGES AND INTEREST) FOR TAXABLE PERIOD COVERING JANUARY 1, 2012 TO JUNE 30, 2012.**

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[26] *Id.*, pp. 1120-1140.
[27] *Id.*, pp. 1111-1113.
[28] *Id*, p. 1115.
[29] *Id.*, p. 1141.
[30] JSFI, Docket, Vol. II, p. 838.

## THE COURT'S RULING

### Timeliness of the Petition

The Court shall determine first whether or not the Petition for Review was timely filed.

Section 228 of the 1997 NIRC provides:

> "SEC. 228. *Protesting of Assessment.* – When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings: *Provided, however,* That a preassessment notice shall not be required in the following cases:
>
> xxx xxx xxx
>
> The taxpayers shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.
>
> Within a period to be prescribed by implementing rules and regulations, the taxpayer shall be required to respond to said notice. If the taxpayer fails to respond, the Commissioner or his duly authorized representative shall issue an assessment based on his findings.
>
> Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment in such form and manner as may be prescribed by implementing rules and regulations. Within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final.
>
> If the protest is denied in whole or in part, or is not acted upon within one hundred eighty (180) days from submission of documents, the taxpayer adversely affected

by the decision or inaction may appeal to the Court of Tax Appeals within thirty (30) days from receipt of the said decision, or from the lapse of the one hundred eighty (180)-day period; otherwise, the decision shall become final, executory and demandable."

Based on the above cited provision, petitioner had thirty (30) days from receipt of the denial of the protest within which to file an appeal before this Court. Considering that petitioner received the FDDA on February 2, 2015[31], petitioner had until March 4, 2015 within which to appeal the said FDDA.

Given that the instant Petition for Review was filed on March 4, 2015, the filing thereof is well within the 30-day reglementary period provided in Section 228 of the 1997 NIRC.

**Zero rating of sale of services to PEZA-registered entities**

The crux of the controversy in the present case relates to the proper interpretation of Section 108(B)(3) of the 1997 NIRC, which reads as follows:

> "SEC. 108. *Value-added Tax on Sale of Services and Use or Lease of Properties.* —
>
> xxx xxx xxx
>
> (B) *Transactions Subject to Zero Percent (0%) Rate.* — The following **services performed in the Philippines** by VAT-registered persons shall be subject to zero percent (0%) rate:
>
> xxx xxx xxx
>
> (3) Services rendered to persons or entities whose exemption under special laws or international agreements to which the Philippines is a signatory

[31] *Supra*, note 9.

effectively subjects the supply of such services to zero percent (0%) rate;" *(Emphasis supplied)*

Petitioner argues that sale of services to enterprises registered with the Philippine Economic Zone Authority (PEZA) are considered as effectively zero-rated sales.[32] It further claims that in treating such sale of services as effectively zero-rated, the law does not make any qualification as to the place where the services should be rendered and the condition for such services.[33] For petitioner, all sales of goods and services by a VAT-registered supplier from the Customs Territory to any PEZA-registered enterprise should be treated as zero-rated sales pursuant to Section 108(B)(3) of the 1997 NIRC and the Cross Border Doctrine.[34] Petitioner likewise contends that it is not necessary that the services are rendered entirely within the Economic Zone (ECOZONE) so long as the services will benefit the PEZA-registered enterprise located within the ECOZONE.[35] Petitioner avers that it is sufficient that the services should be ultimately and finally consumed by the PEZA-registered enterprise within the ECOZONE.[36]

On the other hand, respondent posits that sale of services to PEZA-registered enterprises shall be subject to VAT at zero percent (0%), provided that the services are rendered within the ECOZONE and provided further, that the services are rendered in connection with the registered activitiy/ies of the PEZA-registered entities.[37] According to respondent, these requirements are provided for in consideration of the alleged rule that the situs of VAT for sale of services is the place where the service is rendered.[38]

Section 108(B)(3) of the 1997 NIRC is clear. Even a cursory reading of the said provision would reveal that a sale of service by a VAT-registered person to a VAT-exempt person or entity performed in the Philippines is subject to zero-rating. To qualify for VAT zero-rating, the above quoted provision requires that a sale of service must satisfy the following:

1. **Sale of service is performed in the Philippines;** *gr*

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[32] Docket, Vol. II, p. 1132.
[33] *Id.*
[34] *Id.*
[35] *Id.*, p. 1138.
[36] *Id.*
[37] Docket, Vol. I, pp. 85-86.
[38] *Id.*

2. Service is performed by a VAT-registered person; and

3. Service is rendered to persons or entities exempted under special laws or international agreement to which the Philippines is a signatory.

Revenue Regulations (RR) No. 16-05, as amended, issued by the Secretary of Finance to implement the VAT provisions of the 1997 NIRC, echoes the wording of Section 108(B)(3) of the 1997 NIRC as it also provides that effectively zero-rated sale of services shall be performed in the Philippines. Section 4.108-5 of the said Revenue Regulations, in part, reads:

> "**SECTION 4.108-5.** ***Zero-Rated Sale of Services.*** —
>
> **(a)** ***In general.*** — A zero-rated sale of service (by a VAT-registered person) is a taxable transaction for VAT purposes, but shall not result in any output tax. However, the input tax on purchases of goods, properties or services related to such zero-rated sale shall be available as tax credit or refund in accordance with these Regulations.
>
> **(b)** ***Transactions Subject to Zero Percent (0%) VAT Rate.*** — The following services performed in the Philippines by a VAT-registered person shall be subject to zero percent (0%) VAT rate:
>
> xxx xxx xxx
>
> (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 percent (0%) rate;" *(Underscoring supplied)*

RR No. 16-05, as amended, further provides the definition of an "effectively zero-rated sale of service" as follows:

"**SECTION 4.108-6.** ***Effectively Zero-Rated Sale of Services.*** The term **'effectively zero-rated sales of services'** *Je* shall refer to the local sale of services by a VAT-registered person to a person or entity who was granted indirect tax exemption under special laws or international agreement." *(Underscoring supplied)*

The Philippine VAT system adheres to two interrelated principles: (1) cross border doctrine; and (2) destination principle. According to the Destination Principle, goods and services are taxed only in the country where they are consumed.[39] Thus, exports are zero-rated while imports are taxed. Similarly, the Cross Border Doctrine mandates that no VAT shall be imposed to form part of the cost of the goods destined for consumption outside the territorial border of the taxing authority.[40]

Consistent with the foregoing principles, the Supreme Court ruled in *Commissioner of Internal Revenue v. Toshiba Information Equipment (Phils.), Inc.,*[41] that by virtue of Section 8 of RA No. 7916, as amended, PEZA-registered enterprises located within an ECOZONE are considered VAT-exempt entities. The exemption of these entities from the imposition of VAT flows from the legal fiction established in the said law that deemed ECOZONEs as foreign territories. Accordingly, sales made by suppliers from a customs territory to a purchaser located within an ECOZONE will be considered as exportations.[42] As explained by the Supreme Court:

> "This Court agrees, however, that **PEZA-registered enterprises, which would necessarily be located within ECOZONES, are VAT-exempt entities**, not because of Section 24 of Rep. Act No. 7916, as amended, which imposes the five percent (5%) preferential tax rate on gross income of PEZA-registered enterprises, in lieu of all taxes; but, rather, **because of Section 8 of the same statute which establishes the fiction that ECOZONES are foreign territory**.
>
> It is important to note herein that respondent Toshiba is located within an ECOZONE. An ECOZONE or a Special Economic Zone has been described as

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[39] *Atlas Consolidated Mining and Development Corp. v. Commissioner of Internal Revenue*, G.R. Nos. 141104 & 148763, June 8, 2007, 524 SCRA 102, 103.
[40] *Id.*
[41] G.R. No. 150154, August 9, 2005, 466 SCRA 224 ("Toshiba").
[42] *Coral Bay Nickel Corporation v. Commissioner of Internal Revenue*, G.R. No. 190506, June 13, 2016, 793 SCRA 198.

> . . . [S]elected areas with highly developed or which have the potential to be developed into agro-industrial, industrial, tourist, recreational, commercial, banking, investment and financial centers whose metes and bounds are fixed or delimited by Presidential Proclamations. An ECOZONE may contain any or all of the following: industrial estates (IEs), export processing zones (EPZs), free trade zones and tourist/recreational centers.

The national territory of the Philippines outside of the proclaimed borders of the ECOZONE shall be referred to as the Customs Territory.

**Section 8 of Rep. Act No. 7916, as amended, mandates that the PEZA shall manage and operate the ECOZONES as a separate customs territory; thus, creating the fiction that the ECOZONE is a foreign territory. <u>As a result, sales made by a supplier in the Customs Territory to a purchaser in the ECOZONE shall be treated as an exportation from the Customs Territory</u>.** Conversely, sales made by a supplier from the ECOZONE to a purchaser in the Customs Territory shall be considered as an importation into the Customs Territory." *(Emphasis and underscoring supplied and citations omitted)*

In a similar vein, in the case of *Commissioner of Internal Revenue v. Sekisui Jushi Philippines, Inc.*,[43] the Supreme Court held as follows:

"Notably, while an ecozone is geographically within the Philippines, it is deemed a separate customs territory and is regarded in law as foreign soil. Sales by suppliers from outside the borders of the ecozone to this separate customs territory are deemed as exports and treated as export sales. These sales are zero-rated or subject to a tax rate of zero percent." *(Citations omitted)* Jn

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[43] G.R. No. 149671, July 21, 2006, 496 SCRA 214.

It also bears stressing that in *Toshiba*, the Supreme Court had noted and discussed the BIR's issuance of Revenue Memorandum Circular (RMC) No. 74-99 on 15 October 1999 which clearly established from said date the rule that any sale by a VAT-registered supplier from the Customs Territory to a PEZA-registered enterprise shall be considered an export sale and subject to zero percent (0%) VAT. The said revenue issuance explicitly took into account the Cross Border Doctrine. The relevant portions of *Toshiba* read as follows:

> "The Philippine VAT system adheres to the Cross Border Doctrine, according to which, no VAT shall be imposed to form part of the cost of goods destined for consumption outside of the territorial border of the taxing authority. Hence, actual export of goods and services from the Philippines to a foreign country must be free of VAT; while, those destined for use or consumption within the Philippines shall be imposed with ten percent (10%)[44] VAT.
>
> **Applying said doctrine to the sale of goods, properties, and services to and from the ECOZONES, the BIR issued Revenue Memorandum Circular (RMC) No. 74-99, on 15 October 1999.** Of particular interest to the present Petition is Section 3 thereof, which reads:
>
>> SECTION 3. **Tax Treatment Of Sales Made By a VAT Registered Supplier from The Customs Territory, To a PEZA Registered Enterprise.**
>>
>> (1) If the Buyer is a PEZA registered enterprise which is subject to the 5% special tax regime, in lieu of all taxes, except real property tax, pursuant to R.A. No. 7916, as amended:
>>
>> (a) **Sale of goods (i.e., merchandise)**. This shall be treated as indirect export hence, considered subject to zero percent (0%) VAT, pursuant to Sec. *gr*

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[44] Now twelve percent (12%).

106(A)(2)(a)(5), NIRC and Sec. 23 of R.A. No. 7916, in relation to ART. 77(2) of the Omnibus Investments Code.

(b) **Sale of service**. This shall be treated subject to zero percent (0%) VAT under the ***cross border doctrine*** of the VAT System, pursuant to VAT Ruling No. 032-98 dated Nov. 5, 1998.

(2) If Buyer is a PEZA registered enterprise which is not embraced by the 5% special tax regime, hence, subject to taxes under the NIRC, e.g., Service Establishments which are subject to taxes under the NIRC rather than the 5% special tax regime:

(a) **Sale of goods (i.e., merchandise)**. This shall be treated as indirect export hence, considered subject to zero percent (0%) VAT, pursuant to Sec. 106(A)(2)(a)(5), NIRC and Sec. 23 of R.A. No. 7916 in relation to ART. 77(2) of the Omnibus Investments Code.

(b) **Sale of Service**. This shall be treated subject to zero percent (0%) VAT under the *cross border doctrine* of the VAT System, pursuant to VAT Ruling No. 032-98 dated Nov. 5, 1998.

(3) In the final analysis, **any sale of goods, property or services made by a VAT registered supplier from the Customs Territory to any registered enterprise operating in the ecozone, regardless of the class or type of the latter's PEZA registration, is actually qualified and thus legally entitled to the zero percent (0%) VAT.** Accordingly, all sales of goods or property to such enterprise made by a VAT registered supplier from the Customs Territory shall be treated subject to

> 0% VAT, pursuant to Sec. 106(A)(2)(a)(5), NIRC, in relation to ART. 77(2) of the Omnibus Investments Code, while **all sales of services to the said enterprises, made by VAT registered suppliers from the Customs Territory, shall be treated effectively subject to the 0% VAT, pursuant to Section 108(B)(3), NIRC, in relation to the provisions of R.A. No. 7916 and the Cross Border Doctrine of the VAT system.**
>
> **This Circular shall serve as a sufficient basis to entitle such supplier of goods, property or services to the benefit of the zero percent (0%) VAT for sales made to the aforementioned ECOZONE enterprises** and shall serve as sufficient compliance to the requirement for prior approval of zero-rating imposed by Revenue Regulations No. 7-95 effective as of the date of the issuance of this Circular.

**Indubitably, no output VAT may be passed on to an ECOZONE enterprise since it is a VAT-exempt entity. The VAT treatment of sales to it, however, varies depending on whether the supplier from the Customs Territory is VAT-registered or not.**

**Sales of goods, properties and <u>services</u> by a VAT-registered supplier from the Customs Territory to an ECOZONE enterprise shall be treated as export sales. If such sales are made by a VAT-registered supplier, they shall be subject to VAT at zero percent (0%).** In zero-rated transactions, the VAT-registered supplier shall not pass on any output VAT to the ECOZONE enterprise, and at the same time, shall be entitled to claim tax credit/refund of its input VAT attributable to such sales. Zero-rating of export sales primarily intends to benefit the exporter (*i.e.,* the supplier from the Customs Territory), who is directly and legally liable for the VAT, making it internationally competitive by allowing it to credit/refund the input VAT attributable to its export sales.

Meanwhile, **sales to an ECOZONE enterprise made by a non-VAT or unregistered supplier would only be exempt from VAT and the supplier shall not be able to claim credit/refund of its input VAT**.

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**The rule that any sale by a VAT-registered supplier from the Customs Territory to a PEZA-registered enterprise shall be considered an export sale and subject to zero percent (0%) VAT was clearly established only on 15 October 1999, upon the issuance of RMC No. 74-99.** Prior to the said date, however, whether or not a PEZA-registered enterprise was VAT-exempt depended on the type of fiscal incentives availed of by the said enterprise. This old rule on VAT-exemption or liability of PEZA-registered enterprises, followed by the BIR, also recognized and affirmed by the CTA, the Court of Appeals, and even this Court, cannot be lightly disregarded considering the great number of PEZA-registered enterprises which did rely on it to determine its tax liabilities, as well as, its privileges.

According to the old rule, Section 23 of Rep. Act No. 7916, as amended, gives the PEZA-registered enterprise the option to choose between two sets of fiscal incentives: (a) The five percent (5%) preferential tax rate on its gross income under Rep. Act No. 7916, as amended; and (b) the income tax holiday provided under Executive Order No. 226, otherwise known as the Omnibus Investment Code of 1987, as amended.

xxx xxx xxx

**This old rule clearly did not take into consideration the Cross Border Doctrine essential to the VAT system or the fiction of the ECOZONE as a foreign territory.** It relied totally on the choice of fiscal incentives of the PEZA-registered enterprise. Again,

> for emphasis, the old VAT rule for PEZA-registered enterprises was based on their choice of fiscal incentives: (1) If the PEZA-registered enterprise chose the five percent (5%) preferential tax on its gross income, in lieu of all taxes, as provided by Rep. Act No. 7916, as amended, then it would be VAT-exempt; (2) If the PEZA-registered enterprise availed of the income tax holiday under Exec. Order No. 226, as amended, it shall be subject to VAT at ten percent (10%). **Such distinction was abolished by RMC No. 74-99, which categorically declared that all sales of goods, properties, and <u>services</u> made by a VAT-registered supplier from the Customs Territory to an ECOZONE enterprise shall be subject to VAT, at zero percent (0%) rate, regardless of the latter's type or class of PEZA registration; and, thus, affirming the nature of a PEZA-registered or an ECOZONE enterprise as a VAT-exempt entity**. *(Emphasis and underscoring supplied and citations omitted)*

In light of the foregoing, this Court holds that sale of services by VAT-registered person performed within the Philippines to PEZA-registered entities operating within an ECOZONE shall be subject to zero percent (0%) VAT. Respondent's position stating that a sale of service by VAT-registered persons should be rendered within the ECOZONE and should be directly connected to the activities of PEZA-registered enterprises to qualify for VAT zero-rating is untenable. Such position is not only contrary to the plain wording of the law but also to established jurisprudence, and even to respondent's own revenue issuance.

In his Answer, respondent alleges that the conditions that a sale of service should be rendered within the ECOZONE and should be directly connected to the registered activity/ies of PEZA-registered enterprises to qualify for VAT zero-rating are in consideration of the situs of VAT for sale of services which refers to the place where the service is rendered.[45]

This Court acknowledges that in *Commissioner of Internal Revenue v. American Express International, Inc. (Philippine*

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[45] *Supra*, Note 37.

*Branch)*,[46] the Supreme Court had stated that the tax situs of a zero-rated service is the place where the service is rendered. For proper frame of reference, the relevant portion of the said Decision is quoted below:

> "***Tax Situs of a Zero-Rated Service***
>
> The law neither makes a qualification nor adds a condition in determining the **tax situs of a zero-rated service**. Under this criterion, **the place where the service is rendered determines the jurisdiction to impose the VAT. Performed in the Philippines, such service is necessarily subject to its jurisdiction, for the State necessarily has to have 'a substantial connection' to it, in order to enforce a zero rate.** The place of payment is immaterial; much less is the place where the output of the service will be further or ultimately used." *(Emphasis and underscoring supplied and citations omitted)*

Note that the said Decision discussed the situs of "zero-rated" service and not situs of VAT for a sale of service, contrary to respondent's assertion. The import of the above discussion is that the service must be performed within the Philippines in order for the latter to acquire jurisdiction to subject the sale transaction to VAT. It does not mean that the place where the service is rendered will determine whether to impose VAT on the sale of service at zero percent (0%) or at the regular rate of twelve percent (12%). In other words, it is for the purpose of acquiring jurisdiction to impose VAT that Section 108(B) of the 1997 NIRC requires the performance of service by VAT-registered persons be done in the Philippines before such transaction may qualify for VAT zero-rating.

As regards the other condition, *i.e.*, that the sale of service should be directly connected to the registered activity/ies of PEZA-registered enterprises, this Court reiterates that the VAT exemption of PEZA-registered enterprises flows from the legal fiction establishing ECOZONEs as foreign territories under Section 8 of the RA No. 7916, as amended, and not by virtue of the special tax incentives granted to them under Section 24 of the same law. As such, there is no need to prove that the sale of services to PEZA-

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46 G.R. No. 152609, June 29, 2005, 462 SCRA 219.

registered enterprises are directly connected to their registered activities. What is important is that the PEZA-registered enterprise availing the services is located and operating within the ECOZONE. Bear in mind that effective zero-rating of goods and service is intended to benefit the purchaser who, not being directly and legally liable for the payment of VAT, will ultimately bear the burden of the tax shifted by the buyers.[47] Accordingly, for as long as the PEZA-registered purchaser is located and operating within the ECOZONE, sellers from the Customs Territory cannot pass on any output VAT to it for any sale of goods or services destined for consumption within the ECOZONE.

**Liability for deficiency VAT**

As stated above, a sale of service shall be subject to VAT zero-rating under Section 108(B)(3) of the 1997 NIRC provided the following requirements are met:

1. Sale of service is performed in the Philippines;

2. Service is performed by a VAT-registered person; and

3. Service is rendered to persons or entities exempted under special laws or international agreement to which the Philippines is a signatory.

In the present case, a close scrutiny of the documentary evidence presented by petitioner shows that it failed to present its BIR Certificate of Registration to prove its VAT registration. It goes without saying that such failure is fatal to petitioner's case. By failing to prove that it is a VAT-registered entity, petitioner failed to discharge its burden of proving that its sales of services subject of the assessment clearly qualify for VAT zero-rating under Section 108(B)(3) of the 1997 NIRC.

Under Section 8 of RA No. 1125, as amended, the Court of Tax Appeals (CTA) is categorically described as a court of record.[48] As a

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[47] *Commissioner of Internal Revenue v. Seagate Technology (Philippines)*, G.R. No. 153866, February 11, 2005, 451 SCRA 144.

[48] *Dizon v. Court of Tax Appeals et. al.*, G.R. No. 140944, April 30, 2008, 576 Phil. 111, 128 ("*Dizon*"); *Commissioner of Internal Revenue v. United Salvage and Towage (Phils.), Inc.*, G.R. No. 197515, July 2, 2014, 729 SCRA 113;

court of record, cases filed before the CTA are litigated *de novo* and as such, party-litigants must prove every minute aspect of their cases.[49] By appealing before the CTA, the parties are expected to adduce evidence in support of their respective positions. Stated differently, the parties must present their evidence accordingly if they desire the CTA to take such evidence into consideration.

In assessment cases, the burden of proof is on the taxpayer contesting the validity or correctness of an assessment to prove not only that the CIR is wrong but the taxpayer is right; otherwise, the presumption in favor of the correctness of tax assessment stands. As aptly explained by the Supreme Court in *Sy Po v. Court of Tax Appeals*,[50] to wit:

> "Where the taxpayer is appealing to the tax court on the ground that the Collector's[51] assessment is erroneous, it is incumbent upon him to prove there what is the correct and just liability by a full and fair disclosure of all pertinent data in his possession. **Otherwise, if the taxpayer confines himself to proving that the tax assessment is wrong, the tax court proceedings would settle nothing, and the way would be left open for subsequent assessments and appeals in interminable succession**." *(Emphasis supplied)*

In fine, this Court finds that petitioner failed to establish that it is a VAT-registered entity. Absent this requisite, discussion on the other requirements is unnecessary.

**WHEREFORE**, the present Petition for Review is **DENIED**.

**SO ORDERED.**

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[49] *Commissioner of Internal Revenue v. Philippine National Bank*, G.R. No. 180290, September 29, 2014, 736 SCRA 621-622; *Atlas Consolidated Mining and Development Corporation v. Commissioner of Internal Revenue,* G.R. No. 145526, March 16, 2007, 547 Phil. 332, 339; *Commissioner of Internal Revenue v. Manila Mining Corporation*, G.R. No. 153204, August 31, 2005, 505 Phil. 650, 664.

[50] G.R. No. 81446, August 18, 1988, 164 SCRA 530 citing *Collector of Internal Revenue v. Reyes*, 104 Phil. 1061 (1958) Unrep., Nos. L-11534 and L-11558, November 25, 1958.

[51] Now Commissioner of Internal Revenue.

Juanito C. Castañeda, Jr.
**JUANITO C. CASTAÑEDA, JR.**
Associate Justice

*WE CONCUR:*

**CAESAR A. CASANOVA**
Associate Justice

Catherine T. Manahan
**CATHERINE T. MANAHAN**
Associate Justice

## ATTESTATION

I attest that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

Juanito C. Castañeda, Jr.
**JUANITO C. CASTAÑEDA, JR.**
Associate Justice
Chairperson

## CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, and the Division Chairperson's Attestation, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court.

**ROMAN G. DEL ROSARIO**
Presiding Justice