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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SOUTHERN ENERGY PANGASINAN, INC. [Formerly: PANGASINAN ELECTRIC CORPORATION,
Petitioner,

- versus -

C.T.A. CASE NO. 5654

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
JUL 18 2001

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DECISION

This case involves a claim for refund or issuance of a tax credit certificate in the amount of P286,592,786.25 allegedly representing unutilized input value-added tax (VAT, for brevity) on domestic purchases of capital goods and services for the period April 1, 1996 to March 31, 1998.

Petitioner is a domestic corporation duly organized and existing under and by virtue of the laws of the Philippines with principal office at Barangay Pangascasan, Sual, Pangasinan. It is originally registered with the Securities and Exchange Commission (SEC) under the name "Pangasinan Electric Corporation" (Exhibit A). It is licensed principally to engage in the business of power generation and subsequent sale thereof. It is registered with the Bureau of Internal Revenue as a VAT entity with Certificate of Registration bearing RDO Control No. 05-03219, dated January 22, 1996 (Exhibit B).

For the period April 1, 1996 to March 31, 1998, Petitioner seasonably filed its original Quarterly Value-Added Tax Returns reflecting a nil sale but with accumulated input VAT arising from its domestic purchases of goods and services (Exhibits. D-2, E-2, F-2,G-2, H-2, I-2, J-2, and K-2). The quarterly VAT returns for the second calendar quarter of 1996 to the second calendar quarter of 1997 were simultaneously amended on April 13, 1998 (Exhibits. D, E, F, and G) while the quarterly VAT returns for the third calendar quarter of 1997 to the first calendar quarter of 1998 were simultaneously amended on June 25, 1998 (Exhibits. H, I, J, and K). As of March 31, 1998, Petitioner had accumulated input taxes in the sum of P316,356,744.95. Out of the afore-said amount, Petitioner alleged that the input taxes of P286,592,786.25 pertain to purchases of capital goods and services needed for the construction and development of its power generating plant and its related facilities in Sual, Pangasinan (TSN, December 3, 1998, p. 9).

Pursuant to the procedures prescribed under Revenue Regulations No. 7-95, as amended, Petitioner filed on June 25, 1998, an application for tax credit or refund of the aforementioned unutilized VAT paid on capital goods with the Bureau of Internal Revenue, Revenue Region No. 5, Alaminos, Pangasinan (Exhibit C).

On July 1, 1998, Petitioner instituted the instant Petition for Review in order to toll the running of the two-year prescriptive period under Section 230 of the Tax Code, as amended.

On August 14, 1998, Respondent filed his Answer and raised the following Special and Affirmative Defenses, thus:

1. That Petitioner's claim for input tax refund/credit is still undergoing administrative routinary investigation/examination by Respondent's bureau;

2. Petitioner failed to demonstrate that taxes subject of the instant petition were erroneously or illegally collected on account of its dereliction to present proofs showing that, indeed, its alleged purchases of capital goods are covered by Section 106(B) [now Section112(B) of the Tax Reform Act of 1997];

3. The total amount of P286,592,786.25 being claimed by Petitioner as alleged unutilized input tax credits for the period April 1, 1996 to March 31, 1998 was not substantiated by documents pursuant to Section 4.104.5 of Revenue Regulations No. 7-95;

4. In an action for tax refund/credit, the burden of proof is on the taxpayer to establish its right to refund and failure to sustain the burden is fatal to such claim for refund/credit;

5. Claims for refund/credit are in the nature of tax exemption, hence, construed in *strictissimi juris* against the taxpayer.

Meanwhile, on August 17, 1999, the SEC approved the Amended Articles of Incorporation of Petitioner which changed, among others, its corporate name from Pangasinan Electric Corporation to Southern Energy Pangasinan, Inc. (CTA records, pp. 166 to 180).

Petitioner, due to the voluminous nature of the evidence to be presented, availed of the services of Mr. Ruben R. Rubio, a Partner in the accounting firm of SGV & Company who was commissioned by this Court to verify the accuracy of Petitioner's summary of input taxes (CTA records, p. 50) pursuant to CTA Circular No. 1-95 as amended by CTA Circular No. 10-97. In a report dated February 9, 1999, Mr. Rubio described the audit procedures performed and reported his findings that out of the total claimed input taxes of

P286,592,786.25, a minimal amount of P872.73 is excepted because the corresponding official receipt bears only a stamped VAT number (Exhibit S).

On the other hand, Respondent presented as evidence the Memorandum Report of its Revenue Enforcement Officers, Mr. Zaldy I. Dy and Ms. Bernadette B. Mangaoang, recommending the complete denial of the present claim for refund/credit despite their verification that input taxes in the amount of P75,333,540.54 pertain to capital goods. Pertinent portions of the memorandum report submitted by the revenue examiners are quoted as follows:

> Photocopies of the Amended VAT returns and Invoices/Official receipts were presented for verification. These were authenticated from the original Documents, and the supposed Input Tax were accounted as follows:

Period covered	as claimed	Non Capital goods	Capital goods
1996-2nd QTR	29,002,328.59	26,115,489.44	2,886,839.15
-3rd QTR	30,945,209.03	30,939,486.74	5,722.29
-4th QTR	14,433,285.82	14,401,370.38	31,915.44
Total	74,380,823.44	71,456,346.56	2,924,476.88
1997-1st QTR	27,888,318.87	20,188,090.69	7,700,228.18
-2nd QTR	43,397,047.50	43,381,904.71	15,142.77
-3rd QTR	71,276,296.59	48,729,202.50	22,547,094.09
-4th QTR	48,559,077.78	6,412,479.16	42,146,598.62
Total	191,120,740.60	118,711,676.90	72,409,063.66
GRAND TOTAL	265,501,564.00	190,168,023.40	75,333,540.54

> The non Capital goods as shown above includes payments made to contractors and suppliers whose invoice do not show the breakdown or description of the items paid, amounting to 65,088,493.37 in 1996 and 110,644,597.80 in 1997.
>
> RECOMMENDATION:
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> The undersigned examiners, after an evaluation of the facts and circumstances surrounding the case hereby recommend that the refund be denied on the following grounds:

1. PEC as engaged in Electric power generation is not considered an ordinary VAT taxpayer. They should have applied as VAT zero rated pursuant to Revenue Regulation 7-95 and as contained in a memorandum from the Department of Finance dated Oct. 21, 1997 and January 26, 1998 (see attached copy)

2. In a VAT review committee ruling dated March 11, 1999, it was clearly defined that, without an approved application for zero rating, the transaction otherwise entitled to VAT zero rating shall be considered exempt – as such input tax credits will be treated as part of project cost and expenses.

From the facts thus presented, the issues raised are as follows:

1. What does the term "capital goods" comprise?

2. Is an approved application for zero-rating necessary before the instant claim for refund may prosper?

3. Whether or not the said input taxes have not been applied against its output tax liability.

4. Whether or not the claimable amount is fully substantiated by evidence.

The first aforementioned question was clearly answered in the cases of **Hopewell Power (Philippines) Corp. vs. Commissioner of Internal Revenue, CTA Case No. 5321, dated October 7, 1998**[1]; **and Hopewell Power (Philippines) Corp. vs. Commissioner of Internal Revenue, CTA Case No. 5389, dated January 4, 1999**[2], where this Court ruled, thus:

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[1]With Court of Appeals' Entry of Judgment, dated March 25, 1999.

[2]With Supreme Court Resolution, dated February 21, 2001, denying the petition for review for failure of petitioner to show that a reversible error had been committed by the appellate court. Our decision was affirmed by the Court of Appeals in its Decision, dated March 17, 2000.

Section 2(o) of Revenue Regulations No. 5-87 of the Value-Added Tax Regulations defines capital goods as –

> (o) "Capital goods" refer to goods with estimated useful life greater than one year and which are treated as depreciable assets under Section 29(f), used directly or indirectly in the production or sale of taxable goods or services.

Generally, a capital expenditure involves a payment which creates or enhances what is essentially a separate and distinct asset. Statutorily, capital expenditures are specified as amounts paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate or amounts expended in restoring property or in making good Exhibitaustion thereof for which an allowance is or has been made (6 MERTENS Law of Federal Income Ta; ation, S25.37, pp. 114 to 115).

In determining what constitutes capital goods, courts will look to the origin and character of the expenditure to determine whether it is a capital asset (6 MERTENS Law of Federal Income Taxation, S25.37, p. 115, ***supra***). For example, it was held that "the cost of a topographical survey made for the purpose of establishing boundary lines of the property, of ascertaining the topography of the land, and of recording the location on the property of valuable shrubs and shade trees is a capital expenditure" (Johnson vs. Comm., TC Memo 1955-247, cited in 6 MERTENS Law of Federal Income Taxation S25.63, p. 179). The same treatment is accorded to amounts expended for maps, abstracts, legal title opinions, recording fees and surveys (6 MERTENS Law of Federal Income Taxation, S25.63, p. 179, ***supra***).

The records show that petitioner expended for engineering and structural services for the purpose of constructing power plant facilities needed in the production of electricity, which is petitioner's main product. We are therefore convinced that said expenses are necessary and should form part of the cost of the power plant facilities. (Underlining supplied).

The above pronouncement is on all fours with the case at bar hence, We need not depart from such a conclusion. The records convincingly show that Petitioner expended for the construction of its power generating plant as evidenced by various VAT invoices and official receipts showing payments for the erection of the coal-fired thermal power plant in Sual, Pangasinan. The power plant and its related facilities are within the scope and meaning of capital goods **(Commissioner of Internal Revenue vs. Hopewell Power (Phils.) Corporation, CA-G.R. SP No. 51617, dated March 17, 2000)**.

We now discuss the second issue.

Respondent, in his memorandum, averred that the entitlement of Petitioner to the refund depends on its compliance with Section 4.107-1(d) in relation to Section 4.102-2(b)(3) and (c) of both Revenue Regulations No. 7-95 which requires a prior application with the Revenue District Office for effective zero-rating. And without an approved application for effective zero-rating, the Respondent opines that the transaction otherwise entitled to zero-rating shall be considered exempt.

We agree that an approved application for effective zero-rating is mandatory insofar as the claim for refund of creditable input taxes on goods and services attributable to such effectively zero-rated sales, is concerned. However, Petitioner is not claiming a refund/credit of input taxes paid on goods and services attributable to its "effectively zero-rated sales" but on input taxes paid on capital goods purchased in connection with the construction of its power generating plant. There is a distinct difference between these two types of refund. In fact, the quarterly VAT returns of Petitioner do not show that it had generated effectively zero-rated sales during the period April 1, 1996 to March 31, 1998 for it to claim the input taxes attributable to such sale. We would like to emphasize that Section 106(a) [now 112(a) of the Tax Reform Act of 1997] of the Tax Code does not apply in this case but Section 106(b) [now 112(b)] of the same Code, to quote:

> **SEC. 106.** ***Refunds or tax credits of creditable input tax.*** –
>
> *(a) Zero-rated or Effectively Zero-rated Sales.* – x x x.
>
> (b) *Capital Goods.* – A VAT-registered person may apply for the issuance of a tax credit certificate or refund of input taxes paid on capital goods imported or locally purchased, to the extent that such input taxes have not been applied against output taxes. The application may be made only within two (2) years after the close of the taxable quarter when the importation or purchase was made.

Unlike Section 106(a), Section 106(b) of the Tax Code does not require that a VAT registered person's sale must be zero-rated or effectively zero rated before it can apply for refund of input taxes paid on capital goods. As expressly stated in the law, the Petitioner must only prove that: (1) it is a VAT registered person; (2) the input taxes claimed were paid on capital goods; (3) the input taxes have not been applied against its output tax liability; and (4) the administrative claim for refund was seasonably filed **(Air Liquide Philippines, Inc. vs. Commissioner of Internal Revenue and Commissioner of Customs, CTA Case No. 5652, promulgated on July 6, 2000)**.

Records show that Petitioner satisfactorily complied with the above requisites. Petitioner is registered with the Bureau of Internal Revenue as a VAT-taxpayer (Exhibit B). The input taxes claimed, as discussed earlier, pertain to capital goods. The input taxes sought to be refunded/credited were not utilized by Petitioner because it had no output tax liability during the subject period against which the said taxes could be applied (TSN, February 11, 1999, p. 8). Furthermore, the claimed input taxes in the amount of P286,592,786.25 (included in the amount of P316,356,744.96 for the period January 1, 1995 to March 31, 1998) were already deducted from the accumulated input taxes as of December 31, 1998, as shown in the 1998 fourth quarterly VAT (Exhibits. L, L-1, and

M). This means that Petitioner can no longer utilize the claimed input VAT for its future output tax liabilities. Lastly, the administrative claim for refund was seasonably filed.

What is now left for the Court to determine is the correct amount of input taxes that may be granted to Petitioner on the basis of the evidence presented.

As mentioned earlier, the independent CPA and the revenue examiners have reached different conclusions, therefore the Court deemed it proper to conduct its own verification on the VAT invoices and official receipts that have been submitted in evidence by Petitioner. As a result of this Court's verification and computation, the input taxes in the total amount of P60,347,523.45 were disallowed due to the following reasons:

Supplier	Exhibit	Input VAT	R E M A R K S
Flower Company, Inc.	T-5	P 863.64	Non-capital goods (flowers)
Sual Construction Corp.	T-14	19,095,852.27	Invoice specified zero VAT
GEC Alsthom Power Generation	T-20	6,365,284.09	Invoice specified nil VAT
Activewheels Transport Service	T-29	340.00	Non-capital goods (car rental)
Roberto Q. Dimacali	T-31	872.00	Non-capital goods (clothes)
Exclusively His Tailoring	T-35	492.73	Non-capital goods (uniforms)
GEC Alsthom Power Generation	T-45	6,370,147.73	Invoice specified zero VAT
Triple K Printing Services	T-109	345.69	Non-capital goods (office supplies)
Amstar Company, Inc.	T-111	3,509.10	Non-capital goods (office supplies)
Columbia Technologies Inc.	T-113	3,200.00	Non-capital goods (office supplies)
Vaccare Enterprises	T-137	425.39	Non-capital goods (janitorial services)
Vaccare Enterprises	T-139	443.45	Non-capital goods (janitorial services)
Sual Construction Corporation		27,958,035.47	Not documented
Angel Zamora & Sons	T-167	1,404.55	Non-capital goods (company logo)
E. Arnaldo Lighting Systems	T-173	8,227.27	Non-capital goods (rental of lights)
E. Arnaldo Lighting Systems	T-175	8,227.27	Non-capital goods (rental of sounds)
Floro Blue Printing Inc.	T-176	390.00	Non-capital goods (supplies)
Floro Blue Printing Inc.	T-178	335.45	Non-capital goods (supplies)
Floro Blue Printing Inc.	T-180	528.00	Non-capital goods (supplies)
Vaccare Enterprises	T-184	400.06	Non-capital goods (janitorial services)
Vaccare Enterprises	T-186	392.10	Non-capital goods (janitorial services)
Vaccare Enterprises	T-205	638.03	Non-capital goods (janitorial services)
Vaccare Enterprises	T-207	304.93	Non-capital goods (janitorial services)
Vaccare Enterprises	T-209	375.65	Non-capital goods (janitorial services)
CEPA Operations (Phils) Corp.		526,186.31	Not documented
Gerp Rent A Car	T-211	302.27	Non-capital goods (car rental)
T O T A L		P60,347,523.45	

In sum, Petitioner is entitled to the refund/credit of input taxes in the amount of P226,245,205.85, computed as follows:

Amount sought to be refunded/credited	P286,592,729.30
Less: Court's disallowed input taxes	60,347,523.45
Amount refundable	P226,245,205.85

WHEREFORE, in view of the foregoing, Petitioner's claim for refund is hereby *PARTIALLY GRANTED*. Respondent is **ORDERED to REFUND or ISSUE A TAX CREDIT CERTIFICATE** in the amount of P226,245,205.85 in favor of the Petitioner representing input taxes paid on capital goods for the period April 1, 1996 to March 31, 1998.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

I CONCUR:

AMANCIO Q. SAGA
Associate Judge

CERTIFICATION

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