Republic of the Philippines
**COURT OF TAX APPEALS**
Quezon City

***EN BANC***

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| **COMMISSIONER OF INTERNAL REVENUE,** Petitioner, | **CTA EB NO. 1346** (CTA Case Nos. 8421 & 8561) |
| -versus- | Present: DEL ROSARIO, P.J., CASTAÑEDA, JR. BAUTISTA UY CASANOVA FABON-VICTORINO MINDARO-GRULLA COTANGCO-MANALASTAS and RINGPIS-LIBAN, JJ. |
| **LEAR AUTOMOTIVE SERVICES (NETHERLANDS) B.V. PHILIPPINE BRANCH,** Respondent. | Promulgated: AUG 16 2016 2:53 p.m. |

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# RESOLUTION

***MINDARO-GRULLA, J.:***

This resolves petitioner's "Motion for Reconsideration"[1] of the Decision dated June 2, 2016 of this Court en banc, the pertinent portion of which states:

> *"**WHEREFORE,** the Petition for Review filed by petitioner Commissioner of Internal Revenue is **DENIED,** for lack of merit. Accordingly, the Decision of the Second Division promulgated on May 21, 2015 and Resolution dated July 29, 2015, are **AFFIRMED**. No pronouncement as to costs.*
>
> ***SO ORDERED."***

In assailing this Court's Decision, petitioner maintains its arguments previously raised before the Division of this Court and the Court en banc. Petitioner insists that Republic Act No. 7916 (the PEZA Law) must be given greater weight. Thus, petitioner's claim that BIR Ruling DA-147-2005, which provides that the royalties paid by respondent to Lear are

[1] Filed on June 28, 2016.

considered deductions cannot outweigh the provisions of the PEZA law.

We resolve to deny the motion.

After a careful examination of petitioner's "Motion for Reconsideration", the Court finds that the issues and arguments raised in said motion had already been sufficiently passed upon and fully discussed not only by the Second Division's Decision dated May 21, 2015 and its Resolution, dated July 29, 2015 but also by this Court en banc's Decision dated June 2, 2016.

The list of allowable deductions in the PEZA Law is not meant to be all-inclusive but merely enumerates the expenses that can be considered as direct costs. Other expenses may be deducted provided those expenses are direct costs. This is in line with Revenue Regulations No. 11-2005, which revoked the exclusivity of the items enumerated as direct costs under Revenue Regulations No. 2-2005. To reiterate, we rule as follows:

> *"Section 2 of Rule XX*[2] *of the Rules and Regulations implementing Republic Act No. 7916 (the PEZA Law) and Revenue Regulations No. 11-2005*[3] *provide the allowable*

2 RULE XX
Gross Income Taxation
xxx xxx xxx
SECTION 2. Gross Income Earned; Allowable Deductions. - For purposes of these Rules, Gross Income earned shall be as defined in Section 2(nn), Rule I of these Rules subject to the following allowable deductions for specific types of enterprises:
1. ECOZONE Export Enterprises, Free Trade Enterprises and Domestic Market Enterprises
-Direct salaries, wages or labor expenses
-Production supervision salaries
-Raw materials used in the manufacture of products
-Goods in process (intermediate goods)
-Finished goods
-Supplies and fuels used in production
-Depreciation of machinery and equipment used in production, and buildings owned or constructed by an ECOZONE Enterprise
-Rent and utility charges associated with building, equipment and warehouses, or handling of goods
-Financing charges associated with fixed assets.

3 Regulations Defining "Gross Income Earned" to Implement the Tax Incentive Provision In Section 24 of Republic Act No. 7916, otherwise known as "The Special Economic Zone Act of 1995" Revoking Section 7 of Revenue Regulations No. 2-2005

*deductions from gross income. Revenue Regulations 11-2005 revokes Section 7 of Revenue Regulations 2-2005.[4] Specifically, Revenue Regulations 11-2005 revoked the exclusivity of the items enumerated as direct costs under RR No. 2-2005. This Court's Division aptly ruled as follows:*

> *"On February 15, 2005, the BIR issued Revenue Regulations (RR) No. 2-2005, the pertinent parts of which are quoted as follows:*
>
> > *"SECTION 7. Gross income earned.- xxx For purposes of computing the total five percent (5%) tax rate imposed by Republic Act No. 7227, Republic Act No. 7903, Republic Act No. 7922 and Republic Act No. 7916, the cost of sales or direct cost* ***shall consist only of the following cost or expense items*** *which shall be computed in accordance with Generally Accepted Accounting Principles (GAAP) :" (Emphasis supplied)*
>
> *The BIR issued RR No. 11-2005 on April 25, 2005, removing the exclusivity of the items enumerated as direct costs under RR No. 2-2005, to wit:*
>
> > *"For purposes of computing the total five percent (5%) tax rate imposed, the following direct costs are included in the allowable deductions to arrive at gross income earned for specific types of enterprises:"*
>
> *Section 2 of Rule XX of the PEZA Implementing Rules enumerates the allowable deductions for purposes of computing the 5% tax rate on gross income of PEZA-registered enterprises. It is noteworthy that the Rules did not limit, but merely enumerated the allowable deductions. Subsequently, RR No. 2-2005 limited the direct costs to the enumeration of allowable deductions therein. As it stands, RR No. 11-2005 removed the exclusivity of the allowable deductions from gross Income.*
>
> *In East Asia Utilities Corporation vs. Commissioner of Internal Revenue, this Court discussed the PEZA Law, as amended, in relation to RR Nos. 2-2005 and 11-2005 vis-a-vis the allowable deductions, in this wise:*

and Suspending the Effectivity of Certain Provisions of Revenue Regulations No. 2-2005.

[4] Revenue Regulations Implementing Relevant Provision of Republic Act Nos. 7227, 7916, 7903 and 7922 otherwise known as "Bases Conversion and Development Act of 1992," "Special Economic Zone Act of 1995," "Zamboanga City Special Economic Zone Act of 1995" and "Cagayan Special Economic Zone Act of 1995" respectively

> *"It is clear from the amendment made under RR No. 11-05 that the list is not meant to be all-inclusive but merely enumerates the expenses that can be considered as direct costs. PEZA-registered enterprises may be allowed to deduct expenses which are in the nature of direct costs even though the same are not included in the list.*
>
> *The criteria in determining whether the item of cost or expense should be part of direct cost is the direct relation of such item in the rendition of the PEZA-registered services. If the item of cost or expense can be directly attributed in providing the PEZA-registered services, then it should be treated as direct cost."*

*Thus, there is no merit in respondent's argument that royalty fees are not considered as allowable deduction for purposes of computing the 5% tax on gross income of petitioner. Applying RR No. 11-2005 and the ruling of this Court in the East Asia case, any item of cost or expense which is directly attributable to the rendition of the PEZA-registered services shall be treated as direct cost.*

*xxx xxx xxx.*

*Considering the foregoing, the Court rules that petitioner's royalty payments to Lear should be considered as an allowable deduction for purposes of computing the 5% tax on gross income."*

*It is a cardinal rule that courts "will and should respect the contemporaneous construction placed upon a statute by the executive officers whose duty it is to enforce it x x x."* [5]*In the scheme of judicial tax administration, the need for certainty and predictability in the implementation of tax laws is crucial.*[6] *Our tax authorities fill in the details that "Congress may not have the opportunity or competence to provide."*[7] *The regulations these authorities issue are relied upon by taxpayers, who are certain that these will be followed by the courts.*[8] *Courts, however, will not uphold these authorities' interpretations when clearly absurd, erroneous or improper. We find none in this case."*

[5] COMMISSIONER OF INTERNAL REVENUE vs. CENTRAL LUZON DRUG CORPORATION, G.R. No. 159647, April 15, 2005.
[6] Ibid.
[7] Ibid.
[8] Ibid.

**WHEREFORE**, premises considered, petitioner's "Motion for Reconsideration" is hereby **DENIED** for lack of merit.

**SO ORDERED.**

Cielito N. Mindaro-Grulla
**CIELITO N. MINDARO-GRULLA**
Associate Justice

WE CONCUR:

*(with Concurring Opinion)*
**ROMAN G. DEL ROSARIO**
Presiding Justice

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

**LOVELL R. BAUTISTA**
Associate Justice

**ERLINDA P. UY**
Associate Justice

**CAESAR A. CASANOVA**
Associate Justice

**ESPERANZA R. FABON-VICTORINO**
Associate Justice

**AMELIA R. COTANGCO-MANALASTAS**
Associate Justice

Ma. Belen
**MA. BELEN RINGPIS LIBAN**
Associate Justice

REPUBLIC OF THE PHILIPPINES
**Court of Tax Appeals**
QUEZON CITY

## *EN BANC*

**COMMISSIONER OF INTERNAL REVENUE,**
Petitioner,

- versus -

**LEAR AUTOMOTIVE SERVICES (NETHERLANDS) B.V. PHILIPPINE BRANCH,**
Respondent.

**CTA EB NO. 1346**
(CTA Case Nos. 8421 & 8561)

*Present:*

Del Rosario, *P.J.*,
Castañeda, Jr.,
Bautista,
Uy,
Casanova,
Fabon-Victorino,
Mindaro-Grulla,
Cotangco-Manalastas, *and*
Ringpis-Liban, *JJ.*

Promulgated:
AUG 16 2016 2:53 p.m.

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# CONCURRING OPINION

***DEL ROSARIO, PJ:***

I concur with my esteemed colleague in denying petitioner's Motion for Reconsideration of the Court *En Banc's* Decision dated June 2, 2016 for lack of merit, thereby sustaining the Court in Division's conclusion that respondent's payments of royalties to Lear Automotive Services (Netherlands) B.V. (Lear) are allowable deductions for purposes of computing the five percent (5%) tax on gross income pursuant Section 24 of Republic Act (RA) No. 7916[1] as implemented by Revenue Regulations (RR) No. 11-05.[2]

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[1] Entitled An Act Providing for the Legal Framework and Mechanisms for the Creation, Operation, Administration, and Coordination of Special Economic Zones in the Philippines, Creating for this Purpose, the Philippine Economic Zone Authority (PEZA), and for Other Purposes; It is known as "The Special Economic Zone Act of 1995."

[2] Subject: Regulations Defining "Gross Income Earned" to Implement the Tax Incentive Provision in Section 24 of Republic Act No. 7916, otherwise known as "The Special Economic Zone Act of 1995" Revoking Section 7 of Revenue

I share the view of the majority that the royalties paid by respondent to Lear are part of its cost of sales/direct cost and are therefore deductible for purposes of computing its gross income. Undeniably, said royalty payments are directly related/connected to the production of respondent's PEZA-registered activity as it could not have manufactured and marketed its products without its Licensing Agreement with Lear.

Truth to tell, no less than the Commissioner of Internal Revenue has recognized the deductibility of the subject royalty payments from respondent's gross income for purposes of computing the 5% tax. To be more specific, **BIR Ruling DA 147-2005 dated April 13, 2005 which was issued specifically to respondent in the exercise of the power of the Commissioner of Internal Revenue to interpret tax laws under Section 4 of the NIRC of 1997, as amended, categorically holds that respondent's royalty payments to Lear in consideration for the transfer of technology necessary for the continued production of respondent's products are part of the cost of finished goods and are deductible from gross sales for purposes of computing respondent's taxable gross income subject to 5% tax**.[3]

Considering that BIR Ruling DA 147-2005 takes the nature of a "specific ruling" applicable only to a particular taxpayer[4] *(which is respondent in this case)*, respondent must not be made to suffer for adhering thereto should such interpretation turn out to be erroneous and later on be reversed since the CIR has exclusive and original jurisdiction to interpret tax laws.[5] Indeed, Section 246 of the NIRC of 1997, as amended, expressly provides that a reversal of a BIR ruling cannot adversely prejudice a taxpayer who in good faith relied thereon prior to its reversal.[6]

All told, respondent's royalty payments should appropriately be considered a deductible direct cost for purposes of computing respondent's gross income that is subject to 5% tax.

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Regulations No. 2-2005, and Suspending the Effectivity of Certain Provisions of Revenue Regulations No. 2-2005.

[3] CTA *En Banc* Rollo, p. 70.

[4] CIR vs. San Roque Power Corporation, G.R. No. 187485; Taganito Mining Corporation vs. CIR, GR No. 196113; and Philex Mining Corporation vs. CIR, GR No. 197156, February 12, 2013.

[5] *Id.*

[6] *Id.*

In view of the foregoing, I VOTE to deny the Motion for Reconsideration of the Court *En Banc's* Decision filed by petitioner Commissioner of Internal Revenue.

**ROMAN G. DEL ROSARIO**
Presiding Justice