REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE, Petitioner,	C.T.A. EB No. 1207 (C.T.A. Case No. 8179)
	Present:
-versus-	DEL ROSARIO, *PJ*; CASTAÑEDA, JR., BAUTISTA, UY, CASANOVA, FABON-VICTORINO, MINDARO-GRULLA, COTANGCO-MANALASTAS and RINGPIS-LIBAN, JJ.
EAST ASIA UTILITIES CORPORATION, Respondent.	Promulgated:
	FEB 03 2016 10:35 a.m.

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DECISION

FABON-VICTORINO, J.:

In this Petition for Review[1], petitioner Commissioner of Internal Revenue (CIR) prays that the Court *En Banc* partially reverse and set aside the Decision[2] dated May 21, 2014 and the Resolution[3] dated August 6, 2014 rendered by the Court in Division in C.T.A. Case No. 8179 entitled *East Asia Utilities Corporation vs. Commissioner of Internal Revenue*, then direct respondent East Asia Utilities Corporation to pay the Bureau of Internal Revenue (BIR) a total amount of ₱2,791,894.70 as deficiency Income Tax for taxable year 2006, plus twenty five percent (25%)

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[1] *En Banc* docket, pp. 6-19.
[2] *Ibid.*, pp. 22-58.
[3] *Ibid.*, pp. 59-69.

surcharge and twenty percent (20%) deficiency and delinquency interest for the late payment, pursuant to Sections 248 and 249 of the National Internal Revenue Code (NIRC) of 1997, as amended.

THE FACTS AND THE CASE

Petitioner is the Commissioner of the BIR with the authority to assess and collect all national internal revenue taxes, fees and charges, and to enforce all forfeitures, penalties, and fines relative thereto, with office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

Respondent East Asia Utilities Corporation is a domestic corporation, with principal office at Barangay Ibo, Mactan Export Processing Zone (MEPZ), Lapu-Lapu City, Cebu. It is a registered ECOZONE Utilities Enterprise at the Mactan Economic Zone and West Cebu Industrial Park-Special Economic Zone, as evidenced by Certificate of Registration No. 98-01-U dated April 27, 1998[4] and by Amended Certificate of Registration No. 98-01-U dated April 23, 2009[5] issued by Philippine Economic Zone Authority (PEZA).

Respondent operates a 50.164 megawatt power plant within the Mactan Export Processing Zone[6], which was accredited and certified as a Private Sector Generation Facility by the Department of Energy (DOE) as evidenced by DOE Certificate of Accreditation No. 98-05-40 issued on May 28, 1998.

On January 28, 2000, a Certificate of Board Resolution was issued by PEZA stating that effective January 2000, respondent shall be entitled to incentives under Sections 24 and 42 of Republic Act (R.A.) No. 7916, as amended, including: (a) exemption from national and local taxes, and in lieu thereof, payment of five percent (5%) tax on gross income and (b) additional deduction for training expenses (1/2 of value), subject to the guidelines to be issued by

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[4] Exhibit "B".
[5] Exhibit "B-2".
[6] Exhibit "X".

PEZA in coordination with the Department of Labor and Employment (DOLE) and Department of Finance (DOF)[7].

On July 17, 2009, respondent received from petitioner a Preliminary Assessment Notice (PAN) for alleged tax deficiency in the amount of ₱5,892,780.71, consisting of (a) income tax (IT) in the amount of ₱5,884,985.91 and (b) expanded withholding tax (EWT) in the amount of ₱7,794.80, for calendar year ending December 2006, plus interest upon payment[8].

On August 3, 2009, respondent filed a reply to the PAN dated July 29, 2009.[9]

On September 29, 2009, respondent received a Formal Letter of Demand (FLD)[10] together with Audit Result/Assessment Notice Nos. 123-IT-20-2006-2009-08-063 and 123-WE-20-2006-2009-08-062 dated August 25, 2009[11] demanding payment in the aggregate amount of ₱6,095,971.08, representing deficiency IT of ₱6,087,916.46 and deficiency EWT of ₱8,054.62 for the year 2006.

On October 10, 2009, respondent paid the alleged EWT deficiency of ₱8,054.62 through the BIR's Electronic Filing and Payment System (EFPS)[12].

On October 29, 2009, respondent filed a letter of protest dated October 20, 2009 against the deficiency IT assessment with the information that it already paid the assessed deficiency EWT.[13]

On September 17, 2010, respondent received the Final Decision on Disputed Assessment (FDDA)[14] for deficiency IT in the reduced amount of ₱2,791,894.70, inclusive of increments for taxable year 2006.

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[7] Exhibit "B-1".
[8] Exhibits "F" and "7".
[9] Exhibit "G".
[10] Exhibits "H" and "9".
[11] Exhibits "9-A" and "9-B".
[12] Exhibits "K" to "K-2".
[13] Exhibit "I".
[14] Exhibit "P".

On October 15, 2010, respondent filed with the Court in Division a Petition for Review[15], praying to 1) reverse and set aside the FDDA dated September 17, 2010, and 2) to cancel the FAN dated August 25, 2009 for deficiency IT in the total amount of ₱2,791,894.70, inclusive of surcharges, penalties and interest, for taxable year 2006.

On November 24, 2010, petitioner filed her Answer[16] with the following special and affirmative Defenses: 1) the Petition for Review was filed out of time, hence, the FDDA dated September 17, 2010 became moot and academic; 2) the assessment had attained finality as respondent failed to submit supporting documents within the sixty (60)-day period from filing of protest; 3) the burden of proof lies on respondent to show the incorrectness of the assessment; 4) respondent's books of accounts and pertinent accounting records disclosed its liability to pay the total deficiency IT assessment since the alleged expenses were disallowed; 5) the cited BIR Rulings in favor of PEZA-registered company engaged in the sale of goods are inapplicable given that respondent is engaged in a different field; and 6) tax assessments are entitled to the presumption of correctness and made in good faith.

On June 11, 2013,[17] the case was submitted for decision with respondent's Memorandum filed on June 3, 2013[18] and without any from petitioner[19].

On May 21, 2014, the Court in Division rendered the assailed Decision, the dispositive portion of which reads as follows:

> "**WHEREFORE**, the instant Petition for Review is hereby **PARTIALLY GRANTED**. Accordingly, the assessment for deficiency income tax is UPHELD with modifications. (Respondent) Petitioner is hereby ORDERED TO PAY (petitioner) respondent for deficiency 5% GIT for the year 2006 in the amount of P612,406.94, inclusive of the twenty-five percent (25%) surcharge imposed under Section 248 (A) (3)

[15] Division docket, vol. 1, pp. 5-36.
[16] *Ibid.*, pp. 200-212.
[17] Division docket, vol. V, p. 2385.
[18] *Ibid.*, pp. 2260-2383.
[19] *Ibid.*, p. 2384.

of the NIRC of 1997, as amended, computed as follows:

	NATIONAL GOVERNMENT	TREASURER'S OFFICE, LAPU-LAPU CITY	TOTAL
Basic Tax Due	₱ 293,955.33	₱195,970.22	₱489,925.55
Surcharge	73,488.83	48,992.56	122,481.39
TOTAL	₱367,444.16	₱244,962.78	₱612,406.94

In addition, (respondent) petitioner is hereby ORDERED TO PAY the following:

a) Deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency income tax of P293,955.33 (due to the National Government) and P195,970.22 (due to the Treasurer's Office, Lapu-Lapu City) or in the sum of P489,925.55 computed from April 15, 2007 until full payment thereof pursuant to Section 249 (B) of the NIRC of 1997, as amended:

	NATIONAL GOVERNMENT	TREASURER'S OFFICE, LAPU-LAPU CITY	TOTAL
Basic Tax Due	₱ 293,955.33	₱195,970.22	₱489,925.55
20% Deficiency Interest	Computed from April 15, 2007 until full payment	Computed from April 15, 2007 until full payment	
TOTAL	₱367,444.16	₱244,962.78	₱612,406.94

(b) Delinquency interest at the rate of 20% per annum on the total amount due of P367,444.16 (due to the National Government) and P244,962.78 (due to the Treasurer's Office, Lapu-Lapu City) or in the sum of P612,406.94 and on the deficiency interest which have accrued as aforestated in (a) computed from September 17, 2010 until full payment thereof, pursuant to Section 249 (C) of the NIRC of 1997, as amended:

	NATIONAL GOVERNMENT	TREASURER'S OFFICE, LAPU-LAPU CITY	TOTAL
Basic Tax Due	₱ 293,955.33	₱195,970.22	₱489,925.55
25% Surcharge	73,488.83	48,992.56	122,481.39
TOTAL	₱367,444.16	₱244,962.78	₱612,406.94
20% Deficiency Interest	Computed from September 17, 2010 until full payment	Computed from September 17, 2010 until full Payment	

SO ORDERED."

Both petitioner and respondent moved for partial reconsideration[20] of the foregoing Decision both of which were denied for lack of merit in the similarly assailed Resolution of August 6, 2014.

Far from agreeing with the ruling of the Court in Division, petitioner filed the instant Petition for Review on September 8, 2014, with the following issues for resolution:

I.

WHETHER RESPONDENT IS LIABLE TO PAY THE TOTAL DEFICIENCY INCOME TAX OF ₱2,791,894.70, INCLUSIVE OF PENALTIES AND INTEREST FOR TAXABLE YEAR 2006.

II.

WHETHER THE ENUMERATION OF DIRECT COST UNDER REVENUE REGULATIONS NO. 11-2005 IS EXCLUSIVE CONSIDERING THAT IT WAS PROMULGATED TO IMPLEMENT SECTION 24 OF REPUBLIC ACT NO. 7916 WHICH IS AN EXEMPTION OF TAXES UNDER THE NIRC.

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[20] (Respondent's) Motion for Partial Reconsideration (re: decision dated May 21, 2014), division docket, vol. VI, pp. 2442-2474; (Petitioner's) Motion for Partial Reconsideration, division docket, vol. VI, pp. 2475-2479.

Petitioner claims that respondent erroneously deducted expenses from its gross income which were not in the exclusive enumeration of direct costs for deduction purposes for ECOZONE Developer/Operator, Facilities, Utilities and Tourism Enterprises. Hence, they were correctly disallowed by the Revenue Officers pursuant to Revenue Regulations (RR) No. 11-2005 and in consonance with the principle in statutory construction - *expressio unius est exclusio alterius* or the express mention of one person, thing, act, or consequence excludes all others. Where a statute, by its terms, is expressly limited to certain matters, it may not, by interpretation or construction, be extended to others. The rule proceeds from the premise that the legislature would not have made specified enumerations in a statute had the intention been not to restrict its meaning and to confine its terms to those expressly mentioned.[21]

And since tax exemptions are construed in *strictissimi juris* against the taxpayer, the foregoing interpretation limiting direct costs for purposes of deduction to those enumerated in RR No. 11-2005, should be strictly construed against the taxpayer, citing the case of *San Pablo Manufacturing Corporation vs. Commissioner of Internal Revenue*[22].

Assuming *arguendo* that the list of deductions under RR No. 11-2005 is not exclusive, the aggregate amount of ₱9,798,510.88 should still be disallowed as deduction since they were incurred not in relation to respondent's PEZA-registered activities. Petitioner opines that respondent could still carry on its power generation activities without having to incur the said disallowed expenses.

In rejecting petitioner's averments, respondent counters that:

I. The Second Division correctly ruled that RR 11-2005 is "not meant to be all-inclusive but merely enumerates the expenses that can be considered direct costs."

[21] Agpalo, Statutory Construction, 2nd Ed., 1990 pp. 160-161.
[22] G.R. No. 147749, June 22, 2006.

II. The principle *expressio unius est exclusio alterius* does not apply here because RR 11-2005 uses the word "included" which, as ruled by the Supreme Court, negates the notion of exclusivity in the list of allowable expenses mentioned therein.

III. The CIR's reliance of *San Pablo Manufacturing Corporation v. Commissioner of Internal Revenue* is misplaced and misleading.

IV. The BIR has issued Rulings which confirm that the enumeration of allowable deductions in RR 11-2005 is not an exclusive or closed list.

V. The CTA Allowed Items are directly related to the performance of petitioner's PEZA-registered services, and are thus deductible from its gross income.

RULING OF THE COURT *EN BANC*

To be sure, the arguments set forth by petitioner in the instant Petition for Review are but restatement of her previous arguments in her Motion for Partial Reconsideration filed before the Court in Division and in her Comment to respondent's Motion for Partial Reconsideration, which have been exhaustively considered and discussed in the assailed Decision of May 21, 2014 and in the similarly assailed Resolution of August 6, 2014.

The foregoing observation notwithstanding, and if only to erase petitioner's faulty views, let it be repeated that the list of direct cost under RR No. 11-05 is not all-inclusive and intended merely as a guide in determining the items that may be considered for IT deduction purposes. The relevant portion of the ruling of the Court in Division is hereby quoted as follows:

"Petitioner argues that the enumeration of direct costs under RR No. 11-05 is not an exclusive or closed list of expenses that may be deducted by PEZA-registered enterprises from their gross sales for the purpose of computing the 5% gross income tax (GIT). Instead, the enumeration of direct costs is intended as a guide in determining the items that may be considered direct costs or costs of sales. It noted that RR No. 11-05 amended Section 7 of RR No. 02-05 by deleting the words "consist only" and restating the pertinent phrase to "the following direct costs are included in the allowable deductions . . . ."

The Court agrees with petitioner.

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.

It is important to note that Section 27 (E) (4) of the NIRC of 1997, as amended, defines cost of services as ". . . direct costs and expenses necessarily incurred to provide the services required by the customers and clients including (A) salaries and employee benefits of personnel, consultants and specialists directly rendering the service and (B) cost of facilities directly utilized in providing the service such as depreciation or rental of equipment used and cost of supplies: . . . ."

> Thus, the rest of the costs can be classified as operating expenses which are defined as "primary recurring costs associated with central operations, other than cost of goods sold, which are incurred to generate sales. Operating expenses are normally classified into the following two categories:
>
> a. Distribution costs (or selling expenses)
> b. General and administrative expenses
>
> Distribution costs are those expenses related directly to the company's efforts to generate sales (e.g., sales salaries, commissions, advertising, delivery expenses, depreciation of store furniture and equipment, and store supplies). General and administrative expenses are expenses related to the general administration of the company's operations (e.g., officers and office salaries, office supplies, depreciation of office furniture and fixtures, telephone, postage, accounting and legal services, and business licenses and fees)."

Again, in the assailed Resolution of August 6, 2014, the Court in Division held:

> "To reiterate, the enumeration of direct costs which may be allowed as deductions from the gross income of PEZA-registered enterprises provided under RR No. 11-2005 is not meant to be all-inclusive but merely enumerates the expenses that can be considered as direct costs. RR No. 11-2005 provides that "the following direct costs are included in the allowable deductions to arrive at gross income earned xxx". The use of the word "included" shows that the list is not meant to be exclusive.
>
> The same conclusion was arrived at in the case of *Sterling Selections Corporation vs. Laguna Lake Development Authority*, where the Supreme Court held that the word include means "to take in or comprise as a part of a whole." Thus, it necessarily conveys the very idea of

> non-exclusivity of the enumeration. The principle of *expressio unius est exclusio alterius* does not apply where other circumstances indicate that the enumeration was not intended to be exclusive, or where the enumeration is by way of example only."

As regards petitioner's insistence that even if the list of deductions under RR No. 11-2005 is not exclusive, the disallowed expenses or cost of services should be sustained by the Court since they do not in any way relate to the rendition of respondent's PEZA-registered services.

The grounds for allowance or disallowance of the impugned cost/expenses for deduction shall be discussed *ad seriatim*:

1) Respondent's SSS Employer Cost (₱306,882.12); Pag-ibig Employer Cost (₱24,950.78); Medical/Health Insurance (₱465,621.03); Accident/Life Insurance (₱70,410.55) and Uniform/Working Gears (₱319,257.02)

As found by the Court in Division, respondent's expenses for SSS and Pag-ibig employer cost; medical/health insurance and accident/life insurance; and uniform/working gears cost should be included in its cost of services for the year 2006 given that the said expenses were incurred for respondent's personnel assigned in the Operations and Maintenance Departments in the year 2006. In other words, they formed part of the personnel's compensation and must be allowed as deduction under "direct salaries, wages or labor expenses" of Revenue Regulations (RR) No. 11-2005.

However, the amount of ₱110,147.46, incurred by respondent for the accident/life insurance, working gears and uniform of its OJTs assigned to the Operations and Maintenance Department should be classified as operating expenses and must be disallowed since respondent can still carry on its power generation activities without having to incur cost for its apprenticeship program.

2) Respondent's Employee Activities (₱20,486.59)

The amount of ₱20,486.59, allegedly representing expense for employees activities, was properly disallowed by the Court in Division because while expenses for *pingpong* tournament and treadmill in the physical fitness club and holy mass might promote the physical health as well as the spiritual and moral well-being of respondent's plant operations personnel, they were not directly related or essential to the rendition of its registered service.

3) Respondent's Non-Technical Training and Development (₱31,495.87) and Technical Training and Development (₱125,838.74)

The amount of ₱31,495.87 was likewise correctly disallowed since they were clearly general and administrative costs. On the other hand, respondent's cost for technical training should be considered as direct cost of service, therefore deductible albeit only in the amount ₱97,017.53 since the amount of ₱28,821.21 should be disallowed as it was incurred not for respondent's Operations and Maintenance personnel.

4) Respondent's Hauling and Trucking Services (₱23,952.75)

Through the testimony of respondent's plant manager, Engr. Noel T. Fernandez, it was established that the amount of ₱23,952.75 was part of respondent's cost of services, thus deductible. The said amount was used to rent (1) a crane to relocate concrete poles utilized in connection with respondent's transmission facilities, and (2) a motorized pump boat for the maintenance of respondent's berthing dolphin or fuel platform. The concrete poles and dolphin/fuel platform were essential plant facilities that must be regularly repaired and maintained for respondent's continued and efficient operation.

5) Respondent's expenses relative to Insurance and Freight (₱1,707,489.68); Brokerage Fees (₱261,829.61) and Other Inventory Incidental Cost (₱536,977.10)

Respondent's expenses for Insurance and Freight; Brokerage Fees and Other Inventory Incidental Cost should likewise be included as deductions from gross income as they were incurred to maintain and repair respondent's plant's machinery and equipment. However, the amount of ₱507,336.25 should be disallowed for lack of specification in respondent's invoice pertaining to the contents of shipment, lack of invoice or lack of supporting documents.

6) Respondent's expenses for Insurance-Other Assets (₱152,531.85) and Insurance-Power Plant (₱19,473,119.22)

Respondent's insurance premium payments for its Other Assets and Power Plant in the respective amounts of ₱152,531.85 and ₱19,473,119.22 were also properly deemed as cost of services, consequently deductible. They were paid on a surety bond obtained in connection with respondent's importation of spare parts for the machinery and equipment used in the plant and on premiums for a comprehensive insurance for its truck.

7) Respondent's expense for the DOE Electrification Fund (₱7,338,411.98)

The ₱7,338,411.98 was totally disallowed as deduction for purposes of computing the 5% GIT since it represents the contributions required by PEZA as condition for registration to conduct and operate the business. As such, the mandatory contribution is in the nature of an operating expense, specifically a general and administrative expense.

8) Respondent's cost for Safety programs and Services (₱1,695,767.23) and Other Professional Fees (₱182,939.12)

As held by the Court in Division, except for the other professional fees in the allocated amount of ₱31,937.00,60 which were incurred in 2007, the rest of respondent's expenses pertaining to safety programs and services and other professional fees should be deducted from its gross income since they were costs under "direct materials" or "supplies used" and "rent and utility charges for buildings and capital equipment used in the rendition of registered services" as provided under RR No. 11-05.

9) Respondent's General Office Expense (₱1,057,080.11) Business Expense (₱636,604.54) and Taxes and Licenses (₱36,189.87)

Respondent's General Office Expense in the amount of ₱1,057,080.11, Business Expense of ₱636,604.54 and Taxes and Licenses in the amount of ₱36,189.87 were aptly disallowed since they were primary recurring costs associated with central operations incurred to generate sales. General and administrative expenses are related to the general administration of the company's operations, hence, should not be allowed as deduction from respondent's gross income.

The Court *En Banc* agrees with the findings of the Court in Division that respondent's disallowed cost of services for taxable year 2006 is only in the amount ₱9,798,510.88. Consequently, respondent is still liable to pay deficiency 5%

GIT in the amount ₱489,925.55 on the disallowed expenses of ₱9,798,510.88.

WHEREFORE, the Petition for Review filed by the Commissioner of Internal Revenue on September 8, 2014, is hereby **DENIED**, for lack of merit. Accordingly, the assailed Decision and Resolution promulgated on May 21, 2014 and August 6, 2014, respectively, are **AFFIRMED**.

SO ORDERED.

ESPERANZA R. FABON-VICTORINO
Associate Justice

We Concur:

(With Concurring and Dissenting Opinion)
ROMAN G. DEL ROSARIO
Presiding Justice

Juanito C. Castañeda, Jr.
(I join PJ in his Concurring and Dissenting Opinion)
JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

(I join PJ's Concurring and Dissenting Opinion)
ERLINDA P. UY
Associate Justice

(I join PJ's position)
CAESAR A. CASANOVA
Associate Justice

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

AMELIA R. COTANGCO-MANALASTAS
Associate Justice

Ma. Belen
MA. BELEN M. RINGPIS-LIBAN
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, it is hereby certified that the conclusions in the above Decision were reached in consultation among the members of the Court *En Banc* before the case was assigned to the writer of the opinion of the Court *En Banc*.

ROMAN G. DEL ROSARIO
Presiding Justice

REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

- versus -

EAST ASIA UTILITIES CORPORATION,
Respondent.

CTA EB NO. 1207
(CTA Case No. 8179)

Present:

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

Promulgated:
FEB 03 2016 10:35a.m.

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CONCURRING AND DISSENTING OPINION

DEL ROSARIO, PJ:

I concur with the *ponencia* in denying the Petition for Review as it affirmed the Court in Division's decision.

It is noted that the Court in Division sustained the deficiency income tax assessment *albeit* with modifications due primarily to the reduction in the disallowed cost of services, *i.e., from P34,467,835.76 disallowed by petitioner to P9,798,510.88 as found by the Court in Division.*

The *ponencia*, however, also affirmed the Court in Division's findings that the accident/life insurance and uniform/working gear of On-the-Job Trainees (OJTs) assigned to the Operations and Maintenance Department should be classified as operating expenses and must be disallowed since respondent can still carry on its power generation activities without having to incur cost for its apprenticeship program.

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With utmost respect, I believe that said *accident/life insurance and uniform/working gear of OJTs* are not within the category of "operating expense"; more appropriately, they should be considered as part of the "cost of sales or direct cost of respondent," within the contemplation of Section 3 of Revenue Regulations No. 11-05.[1]

I share the view that the list of direct cost under RR No. 11-05 is not all-inclusive. The said list is intended merely as a guide in determining the items that may be considered as direct costs for purposes of computing gross income. PEZA-registered enterprises are allowed to deduct the amounts incurred which are in the nature of direct costs, even though the same are not included in the list, as long as it is directly related/connected to providing the registered service or producing the product.

Indubitably, the amount of P110,147.46 pertaining to the accident/life insurance and uniform/working gear of respondent's OJTs is part of its cost of sales/direct cost deductible for purposes of

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

"SECTION 3. Gross Income Earned. — For purposes of implementing the tax incentive of registered Special Economic Zone (ECOZONE) enterprises in Section 24 of Republic Act No. 7916, the term "gross income earned" shall refer to gross sales or gross revenues derived from business activity within the ECOZONE, net of sales discounts, sales returns and allowances and minus costs of sales or direct costs but before any deduction is made for administrative, marketing, selling and/or operating expenses or incidental losses during a given taxable period. 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:

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
- Decrease in Goods in Process Account (Intermediate goods)
- Decrease in Finished Goods Account
- Supplies and fuels used in production
- Depreciation of machinery and equipment used in production, and of that portion of the building owned or constructed that is used exclusively in the production of goods
- Rent and utility charges associated with building, equipment and warehouses used in production
- Financing charges associated with fixed assets used in production the amount of which were not previously capitalized

2. ECOZONE Developer/Operator, Facilities, Utilities and Tourism Enterprises:

- Direct salaries, wages or labor expense
- Service supervision salaries
- Direct materials, supplies used
- Depreciation of machineries and equipment used in the rendition of registered services, and of that portion of the building owned or constructed that is used exclusively in the rendition of registered service
- Rent and utility charges for buildings and capital equipment used in the rendition of registered services
- Financing charges associated with fixed assets used in the registered service business the amount of which were not previously capitalized.

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computing gross income as it is directly related/connected to the provision of the registered service of respondent. **In other words, the said amount incurred for OJTs directly benefited the power generation activities of respondent; hence, a deductible direct cost for purposes of computing the gross income**.

Accordingly, the deficiency income tax assessment must further be modified in view of the additional reduction of disallowed direct cost by P110,147.46. As the disallowed cost of service for taxable year 2006 should only be P9,688,363.42 *(9,798,510.88 less P110,147.46)*, respondent should be ordered to pay deficiency 5% gross income tax in the reduced amount of P484,418.17, plus penalties.

In view of the foregoing, I vote to deny the petition for review for lack of merit and to affirm with modification the judgment of the Court in Division, that is ordering the respondent to pay the deficiency 5% gross income tax in the reduced amount of P484,418.17, plus penalties.

ROMAN G. DEL ROSARIO
Presiding Justice