Republic Of The Philippines
COURT OF TAX APPEALS
Quezon City

SECOND DIVISION

SMI-ED PHILIPPINES TECHNOLOGY, INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 6532

Members:

CASTAÑEDA, *Chairman,*
UY, and
PALANCA-ENRIQUEZ, JJ

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

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DECISION

CASTAÑEDA, JR., *J.*

This case involves a claim for refund in the amount of P44,677,500.00 allegedly representing the erroneously paid five percent (5%) final tax upon the sale of the petitioner's factory and other buildings including the machinery and equipment installed therein pursuant to Republic Act No. 7916.

The antecedent facts of the case are as follows:

Petitioner is a corporation duly organized and existing under Philippines laws, with principal office address at First Philippine Industrial Park, Barangay Sta.

Anastacia, Sto. Tomas Batangas, and is registered with the Securities and Exchange Commission *(Paragraph 1, Joint Stipulation of Facts and Issues).*

On June 29, 1998, petitioner was registered with the Philippine Economic Zone Authority ("PEZA") as an Ecozone Export Enterprise under Republic Act No. 7916 *(Exhibit B; Paragraph 3, Joint Stipulation of Facts and Issues)* to engage in the business of manufacturing ultra high-density microprocessor unit package *(page 200, CTA Records).*

Petitioner constructed a factory and other buildings within the aforesaid office address, and purchased/imported machineries and equipment to be installed therein at a total cost of P3,150,925,917.00 as of December 31, 1999 *(Paragraph 4, Petition for Review, Exhibit C).* However, it failed to operate said business since petitioner's Board of Directors initially approved the temporary closure of its factory effective October 15, 1999, even before it began its operation due to the last Asian financial crisis, and subsequently, its dissolution was finally approved by its directors and stockholders effective November 30, 2000 *(Exhibit H; Paragraph 2, Supplemental Joint Stipulation of Facts).*

Consequently, in preparation for its closure and dissolution, a Deed of Absolute Sale dated August 1, 2000 *(Exhibit J)* was executed and entered into by and between the petitioner and Ibiden Philippines, Inc., an unrelated but also registered company with the PEZA, involving the subject factory and other buildings including certain machinery and equipment installed therein, for the total consideration of ¥2,100,000,000.00 (equivalent to P893,550,000.00) *(Exhibit D; Paragraph 3, Supplemental Joint Stipulation of Facts).*

On September 13, 2000, petitioner filed its quarterly income tax return for the third quarter of calendar year 2000 and subjected the entire gross sales of the aforesaid transaction to the 5% final tax and paid the tax of P44,677,500.00 *(Exhibits E to E-2; Paragraph 4, Supplemental Joint Stipulation of Facts).*

Subsequently, petitioner requested for the cancellation of its registration as an Ecozone Export Enterprise from PEZA, which was eventually granted effective September 20, 2000 *(Exhibit I).*

On January 18, 2001, petitioner filed with the Securities and Exchange Commission an application to amend its Articles of Incorporation to shorten its corporate term *(Paragraph 5, Supplemental Joint Stipulation of Facts).*

On February 2, 2001, petitioner filed with the Large Taxpayers Division or LTD (now Large Taxpayers District Office or LTDO) of the Bureau of Internal Revenue (BIR) its administrative claim for refund in the amount of P44,677,500.00 representing the alleged erroneously paid 5% final tax *(Exhibit G; Paragraph 8, Joint Stipulation of Facts and Issues).*

Furthermore, on March 1, 2001, petitioner filed its final income tax return for the short 11-month period ending November 30, 2000 *(Paragraph 5, Joint Stipulation of Facts)*, indicating an alleged net loss of P2,233,464,538.00 and an alleged refundable amount of P44,677,500.00 for the erroneously paid 5% tax *(Exhibit F).*

Alleging inaction on the part of the respondent and in order to stop the running of the two-year prescriptive period, petitioner elevated the case through a Petition for Review with this Court on September 9, 2002.

By way of an Answer filed on October 10, 2002, respondent asserted the following Special and Affirmative Defenses:

> 4. Petitioner's alleged claim for refund/tax credit is subject to administrative routinary examination/investigation by the respondent's Bureau;
>
> 5. Petitioner failed miserably to show that the total amount of P44,677,500.00 claimed as erroneously paid tax was erroneously or illegally collected or that the same was properly documented;
>
> 6. Taxes paid and collected are presumed to have been paid in accordance with law; hence, not refundable;
>
> 7. In an action for tax refund/credit, the taxpayer has the burden to establish its right to refund, and failure to sustain the burden is fatal to the claim for refund; and
>
> 8. It is incumbent upon petitioner to show that it has complied with the provisions of Section 204 (C) in relation to Section 229 of the Tax Code.

After trial on the merits, the Court issued a resolution on August 10,2004 submitting the case for decision after failure of respondent to file his memorandum within the given period.

The parties filed their Joint Stipulation of Facts and Issues on January 24, 2003 manifesting their mutual agreement on the issues involved in this case, to wit:

> 1. What was the book value of the structures, equipment and machinery sold by the petitioner at the point of sale?

2. Whether Petitioner sold the structures, equipment and machinery at a loss (selling price is less than the book value of the structures, equipment and machinery)?

3. Whether Petitioner erroneously paid the 5% final tax in the amount Forty Four Million Six Hundred Seventy Seven Thousand Five Hundred Pesos (Php44,677,500.00) Philippine Currency considering that it was under the ITH regime at the time of sale?

4. Whether the sale of the structures, equipment and machinery is part of the registered activity of the Petitioner?

5. In the alternative that Petitioner is not entitled to ITH since the sale is not part of the registered activity of the Petitioner, whether Petitioner is liable for income tax on the sale of the structures, equipment and machinery?

6. Whether or not Petitioner is legally and factually entitled to claim refund of its erroneously paid taxes in the amount of Forty Four Million Six Hundred Seventy Seven Thousand Five Hundred Pesos (Php44,677,500.00) Philippine Currency.

After a cursory reading of the Joint Stipulation of Facts and Issues of the parties, this Court finds that the main issue in this case, despite the numerous matters raised, basically boils down to "whether or not petitioner is legally and factually entitled to claim for a refund of erroneously paid final tax in the amount of Forty Four Million Six Hundred Seventy Seven Thousand Five Hundred Pesos (Php44,677,500.00) Philippine Currency".

To begin with, it bears stressing that tax refunds are in the nature of tax exemptions. As such, they are regarded as in derogation of sovereign authority and to be construed in *strictissimi juris* against the person or entity claiming the exemption (***Commissioner of Internal Revenue vs. Procter and Gamble Phil. Mfg. Corp., 204 SCRA 377; Commissioner of Internal Revenue vs. S.C. Johnson***

& Son, Inc., 309 SCRA 87). Thus, the claimant must be able to establish clearly and convincingly that it is entitled to such exemption.

Petitioner anchored its claim for refund on Section 204 in relation to Section 229 of the Tax Code, to wit:

> "**SEC. 204. Authority of the Commissioner to Compromise, Abate and Refund or Credit Taxes.** -- The Commissioner may --
>
> xxx xxx xxx
>
> (C) Credit or refund taxes erroneously or illegally received or penalties imposed without authority, refund the value of internal revenue stamps when they are returned in good condition by the purchaser, and, in his discretion, redeem or change unused stamps that have been rendered unfit for use and refund their value upon proof of destruction. <u>No credit or refund of taxes or penalties shall be allowed unless the taxpayer files in writing with the Commissioner a claim for credit or refund within two (2) years after the payment of the tax or penalty</u>: x x x"
>
> "**SEC. 229. Recovery of Tax Erroneously *or* Illegally Collected.** -- No suit or proceeding shall be maintained in any court for the recovery of any national internal revenue tax hereafter alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessively or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Commissioner; <u>but such suit or proceeding may be maintained</u>, whether or not such tax, penalty, or sum has been paid under protest or duress.
>
> <u>In any case, no such suit or proceeding shall be filed after the expiration of two (2) years from the date of payment of the tax or penalty regardless of any supervening cause that may arise after payment</u>: x x x" *(Underscoring supplied)*

Applying the aforequoted provisions, this Court finds that petitioner has indeed established the facts that it was able to file both its administrative and judicial claims for refund within the aforesaid period. The two-year prescriptive period for the filing of a claim for refund commences from the date of filing of the final adjustment return ***(ACCRA Investments Corporation vs. Court of Appeals, 204 SCRA 957)***. Based on the records, petitioner filed its third quarterly income tax return for the taxable year 2000 on September 13, 2000 *(Exhibit E-1)*. And its final adjustment return of petitioner for its 2000 taxable year was filed on March 1, 2001 *(Exhibit F)*. Counting from the latter date, petitioner had in fact until March 3, 2003 (March 1, 2003 being a Saturday) within which to file a claim for refund of its alleged erroneously paid 5% preferential tax. Hence, petitioner's administrative claim for refund filed on February 2, 2001 *(Exhibit G)* and the present Petition for Review filed on September 9, 2002 were filed well within the two-year prescriptive period.

Now, in determining the basis of such claim, this Court deems it apropos to first resolve the other issues raised by the parties, and for this purpose, it is important to discuss the focal provisions of R.A. No. 7916, also known as "The Special Economic Zone Act of 1995", granting benefits and incentives to pioneer and non-pioneer firms duly registered with the PEZA as an "Economic Export Enterprise", considering that petitioner is a PEZA registered company, pertinent portions of which read:

> "**Sec. 23.** ***Fiscal Incentives.*** – Business establishments operating within the ECOZONES shall be entitled to the fiscal incentives as provided for under Presidential Decree No. 66, the law creating the Export Processing Zone Authority, or those provided for

under Book VI of Executive Order No. 226, otherwise known as the Omnibus Investment Code of 1987. x x x

Sec. 24. ***Exemption from Taxes Under the National Internal Revenue Code.*** – Any provision of existing laws, rules and regulations to the contrary notwithstanding, no taxes, local and national, shall be imposed on business establishments operating within the ECOZONE. In lieu of paying taxes, five percent (5%) of the gross income earned by all businesses and enterprises within the ECOZONE shall be remitted to the national government. x x x" (Underscoring supplied)

In interpreting exhaustively said provisions of law, We reiterate our dissertation in the recent case of ***ROHM Apollo Semiconductor Philippines, Inc. vs. Honorable Commissioner of Internal Revenue, CTA Case No. 6534, May 27, 2004***, wherein We ruled:

Although it is provided under Section 24 of RA No. 7916 that PEZA registered enterprises are subject to 5% tax on gross income in lieu of national and local taxes including VAT, it is incorrect for the respondent to automatically assume that petitioner is subject to the 5% tax on gross income. This court had already ruled on several occasions that there are two sets of fiscal incentives available to a PEZA registered enterprise, namely: 1) incentives under Presidential Decree No. 66, as amended, and Section 24 of RA No. 7916, which include the 5% preferential tax rate on gross income earned in lieu of national and local taxes; and 2) incentives under Book VI of Executive Order (EO) No. 226, as amended, which include income tax holiday for 4 to 6 years, depending on whether the enterprise is registered as pioneer or non-pioneer. These two sets of incentives are in the alternative and cannot be availed of at the same time by a PEZA registered enterprise ***(Hitachi Computer Products Asia [Asia] Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5943, August 6, 2001 as affirmed by the Court of Appeals in Commissioner of Internal Revenue vs. Hitachi Computer Products [Asia] Corporation, CA-G.R. SP No. 66342, April 25, 2003).***

From the above-quoted provisions, it is likewise clear that in order for the PEZA registered company, business establishment or firm to avail of such benefits and incentives granted therein, the PEZA registered company, business establishment or firm should have already commenced its "operation". By the term "operation", it refers to the operation of the business, the nature of which is clearly defined in its certificate *(Exhibit B)* issued by the PEZA. With this premise, the Court will now look into the status of petitioner in resolving the third stipulated issue.

A careful review of the evidence on record discloses that petitioner was able to prove that it has not commenced its operation since it became a PEZA registered enterprise on June 29, 1998 *(Exhibit B)*. Hence, it shall not be entitled to the benefits and incentives granted under the law, including the Income Tax Holiday (ITH) and the 5% preferential tax, among others. In effect, petitioner shall be subject to taxes, both local and national.

A further scrutiny of the records reveals that the only income reported by petitioner consists of the proceeds from the sales transaction it entered into with Ibiden Philippines, Inc., involving the factory and buildings including certain machineries and equipment to be used in its business, amounting to P893,550,000.00, as evidenced by its third quarter income tax return for the taxable year 2000 *(Exhibit E)*. Said return clearly shows that petitioner has mistakenly subjected the same amount of P893,550,000.00 to the 5% preferential tax which is available only to PEZA registered companies doing business within the Zone. The entire amount of P44,677,500.00 was therefore erroneously paid to and duly received by respondent as evidenced by Revenue Official Receipt 1999 No. 01247570 dated September 13, 2000 *(Exhibit E-2)*.

The fourth and fifth issues will be discussed jointly for being interrelated. This Court, however, finds it essential to first determine the nature of the properties involved in the case at bar, more particularly, as regards the question of whether the same may be considered as ordinary or capital assets, before resolving the aforesaid issues.

Section 39(A)(1) of the 1997 National Internal Revenue Code provides:

"**Sec. 39. Capital Gains and Losses.** –

> **(A) Definitions.** – *As used in this Title* –
>
> **(1) Capital Assets.** – The term **"capital assets"** means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or <u>property **used** in the trade or business, of a character which is subject to the allowance for depreciation provided in Subsection (F) of Section 34; or real property **used** in trade or business of the taxpayer</u>." *(Emphasis and underscoring supplied)*

The statutory definition of capital assets is negative in nature ***(Nolledo, Commentaries and Jurisprudence on the NIRC, 1973 Ed., p. 314)***. The law defines the term by exclusion. If the taxpayer sells or exchanges any of the properties enumerated, any gain or loss relative thereto is an ordinary gain or loss; the gain or loss from the sale or exchange of all other properties of the taxpayer is a capital gain or a capital loss ***(Tuason, Jr. vs. Lingad, 58 SCRA 170).***

It is worthy to note that the subject properties in the case at bar constitute real properties *intended to be used* by petitioner in its business operation, particularly the factory, other buildings, certain machineries and equipment attached therein, as specifically identified by the parties in Annex "A" of the subject Deed of Absolute Sale *(Exhibit D)*. However, the same were *not actually used* considering that petitioner failed to commence its business operation due to its closure even before it started operation. These facts were uncontested by the respondent. *(Paragraph 5, Joint Stipulation of Facts and Issues)*.

The Court is guided by the principles laid down by the Honorable Supreme Court that in the determination of whether a piece of property is a capital asset or an ordinary asset, a careful examination and weighing of all circumstances revealed in each case must be made. In ***Calasanz vs. Commissioner of Internal Revenue, 144 SCRA 664,*** the Supreme Court ruled that there is no rigid rule or fixed formula by which it can be determined with finality whether property sold by a taxpayer was held primarily for sale to customers in the ordinary course of his trade or business or whether it was sold as a capital asset ***(Victory Housing No. 2 vs. Commissioner, 205 F. 2d 371)***.

One may, of course, liquidate a capital asset. To do so, it is necessary to sell. The sale may be conducted in the most advantageous manner to the seller and he will not lose the benefits of the capital gain provision unless he enters the real estate business and carries on the sale in the manner in which such a business is ordinarily conducted. In that event, the liquidation constitutes a business and a sale in the ordinary course of such a business and the preferred tax status is lost ***(Calasanz vs.***

Commissioner of Internal Revenue, supra; citing Home Co., Inc. vs. Comm., 212 F 2d 637; De Leon on NIRC, 2000 Ed., p. 307).

In determining the *correct boundary between the two types of assets*, the following may be considered as helpful guides, although these factors are not conclusive:

(a) the purpose for which the property was initially acquired;

(b) the purpose for which the property was subsequently held;

(c) the extent to which improvements, if any, were made;

(d) the frequency, number, and continuity of sales;

(e) the extent and nature of the transactions involved;

(f) the ordinary business of the taxpayer;

(g) the extent of advertising, promotion, or other activities used in soliciting buyers for the sale of the property;

(h) the listing of the property with brokers; and

(i) the purpose for which the property was held at the time of sale.

Nevertheless, each case must in the last analysis rests upon its own peculiar facts and circumstances ***(Calasanz vs. Commissioner of Internal Revenue, supra; Tuazon vs. Lingad, supra; citing Klarkowski, TCM 1965-328, Aff'd. 385 F[2d] 398 [CA], 1967).***

Prescinding from the above, it can be undeniably established that the subject properties sold by petitioner to Ibiden Philippines, Inc. are considered capital assets for the following reasons:

1) The factory, buildings, machineries and equipment attached thereto are properties which **do not include** stock in trade of the taxpayer or other properties of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year;

2) The factory, buildings, machineries and equipment attached thereto are properties held by the taxpayer **not primarily for sale** to customers in the ordinary course of his trade or business;

3) The factory, buildings, machineries and equipment attached thereto are properties **not yet used** in the trade or business, of a character which is subject to the allowance for depreciation provided in Subsection (F) of Section 34; and

4) The factory, buildings, machineries and equipment attached thereto are real properties **not yet used** in trade or business of the taxpayer.

By force of logic, the subject properties sold by petitioner to Ibiden Philippines, Inc. are classified as real properties **not excluded** by the definition of "capital assets" provided for under Section 39(A)(1) of the 1997 NIRC. *(Emphasis supplied)*

To reiterate, "the option to buy or sell property is regarded a capital asset if the optioned property constitutes, or if acquired would constitute, a capital asset in the hands of the taxpayer. x x x Property held for the production of income but not used in the trade or business of the taxpayer, is included in the term 'capital assets' All those properties specifically excluded are considered ordinary assets and the profits realized therefrom must necessarily have to be treated as ordinary gains". ***(Gonzales and Robledo-Gonzales on NIRC, 2001 Ed., p. 239)***

The subject properties having been indubitably established as capital assets, as such, the same are not subject to corporate income tax but to capital gains tax.

Section 27(D)(5) of the 1997 NIRC explicitly provides:

SEC. 27. Rates of Income Tax on Domestic Corporations. –

> xxx xxx xxx
>
> **(D) Rates of Tax on Certain Passive Incomes. –**
>
> xxx xxx xxx
>
> **(5) Capital Gains Realized from the Sale, Exchange or Disposition of Lands and/or Buildings.** – A final tax of six percent (6%) is hereby imposed on the gain presumed to have been realized on the sale, exchange, or disposition of lands and/or buildings which are **not actually used in the business of a corporation and are treated as capital assets, based on the gross selling price or fair market value as determined in accordance with Section 6(E) of this Code, whichever is higher, of such lands and/or buildings.** *(Emphasis and underscoring supplied)*

In addition, Section 2 of Revenue Regulations No. 8-98 provides, that:

> **SECTION 2. Final Tax on Sales, Exchanges or Transfers of Real Properties Classified as Capital Assets.** – The rate of six percent (6%) shall be imposed on capital gains presumed to have been realized by the seller from the sale, exchange or other disposition of real properties located in the Philippines, classified as capital assets, including pacto de retro sales and other forms of conditional sales **based on the gross selling price or fair market value as determined in accordance with Section 6(E) of the Code (i.e. the authority of the Commissioner to prescribe the real property values), whichever is higher.** x x x *(Emphasis and underscoring supplied)*

From the foregoing and considering the above provisions, this Court hereby concludes that the properties sold by petitioner consisting of the factory, other buildings, machineries and equipment attached therein, which We have already classified as capital assets as defined under Section 39(A)(1) of the 1997 National Internal Revenue Code, are not subject to the corporate income tax. It is however subject to capital gains tax as provided for under Section 27(D)(5) of the same Code.

But no capital gains tax was ever paid on the sale of the subject properties as both the vendor and the vendee were PEZA registered enterprises, pursuant to the provision of R.A. 7916 earlier cited. However, as heretofore discussed, petitioner is not entitled to the benefits under said law. Therefore, it is liable to pay the 6% capital gains tax. Using gross selling price as basis, this amounts to P53,613,000.00 (P893,550,000.00 x 6%). The petitioner having paid already to the government the amount of P44,677,500.00, there remains a balance of P8,935,500.00 in basic deficiency tax, which respondent should perhaps look into.

WHEREFORE, premises considered, the instant petition is hereby **DENIED**.

SO ORDERED.

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

WE CONCUR:

ERLINDA P. UY
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

CERTIFICATION

I hereby certify that the above decision was reached after due consultation with the members of the Division of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Chairman