REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SECOND DIVISION

MOOG CONTROLS CORPORATION-PHILIPPINE BRANCH	**CTA Case No. 9077**
Petitioner,	Members:
-versus-	**CASTAÑEDA, JR.**, *Chairperson* **CASANOVA**, *and* **MANAHAN**, *JJ.*
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	Promulgated: JAN 03 2018 1:05 p.m.

x- x

D E C I S I O N

MANAHAN, *J.:*

This involves a Petition for Review filed on June 23, 2015 by Moog Controls Corporation-Philippine Branch, as petitioner, against the Commissioner of Internal Revenue, as respondent, before the Court in Division.

Petitioner seeks the cancellation and withdrawal of the deficiency income tax assessment issued against it for fiscal year ended October 3, 2009 in the total amount of Php12,206,739.18.

THE PARTIES

Petitioner is a foreign corporation organized and existing under the laws of Ohio, United States of America. It has been licensed to do business as a branch here in the Philippines under Securities and Exchange Commission (SEC) License No. 1113 dated December 14, 1984. It is engaged in the manufacture, assembly of parts and components and assemblies of electro-hydraulic servo, electronic, pneumatic, electric and hydraulic valves, controls, motors and other devices for use in aerospace and industrial applications. [1] It is also registered with the Philippine Economic Zone Authority (PEZA) with business address at Loakan Road, Baguio City, Philippines.

Petitioner as a PEZA-registered export enterprise is entitled to the five percent (5%) preferential tax regime on gross income earned pursuant to Republic Act (RA) No. 7916 (PEZA law), as implemented by Revenue Regulations (RR) No. 11-2005.

Respondent is the duly appointed Commissioner of Internal Revenue (CIR) vested with the powers and duties, among others, to assess and collect all national internal revenue taxes and to decide, approve and grant tax protests. He holds office at the 5th floor, BIR National Office Building, BIR Road, Diliman, Quezon City.

FACTS

As stated in the Joint Stipulation of Facts and Issues (JSFI)[2] filed with this Court on 11 December 2015, the factual antecedents are as follows:

"4. The BIR issued a Final Assessment Notice (FAN) and Formal Letter of Demand[3] (FLD), both dated August 15, 2014, which were received by petitioner's representative on August 18, 2014, assessing petitioner for alleged deficiency income tax for fiscal year (FY) ended October 3, 2009 in the total amount of ₱12,206,739.18, inclusive of interest up to August 31, 2014,[4] computed as follows:

Assessment No. ELTAD-II-IT-09-0020		
Revenue per Income Tax Return		₱3,428,320,610.00
Less: adjusted Cost of Goods Sold		3,209,377,272.46
Gross Profit		218,943,337.54
Add: Other Income		12,498,078.00
Total Gross Income		231,441,415.54
Multiply by tax rate		5%
Gross income tax due		11,572,070.78
less: Gross income tax paid per return		
share (2%) of other agency	2,069,690.00	

[1] Joint Stipulation of Facts and Issues ("JSFI"), Court Docket, pp. 169-174.
[2] JSFI, Court Docket, pp 291-299.
[3] Exhibit "P-5",Court Docket, pp. 219-223; Exhibit "R-5", BIR Records, pp. 306-310.
[4] Par. 4, Summary of Admitted Facts, JSFI, Court docket, p. 170.

per 1702Q / 1702	3,104,535.00	5,174,225.00
Income tax due		6,397,845.78
Add: interest up to 8-31-2014		5,808,893.40
Total deficiency income tax		**₱12,206,739.18**

5. In the Details of Discrepancies, the BIR stated that:

> Revenue Regulations 11-2005 was issued to implement the tax incentive provision of RA 7916 and Rule XX of the Rules & Regulations to Implement RA 7916 (PEZA). The enumerated/listed allowable deductions, under Revenue Regulations 11-2005 and Rule XX of the Rules & Regulations to Implement RA 7916 (PEZA), are exclusive under the maxim expressio unius est exclusio alterius, the mention of one thing implies the exclusion of another thing not mentioned, as ruled in BIR Ruling No. 014-12 dated January 4, 2012 of the Commissioner of Internal Revenue. BIR Ruling No. 014-12 revoked all other existing rulings inconsistent thereto, hence the BIR Rulings you presented were not considered.[5]

6. Based on the Details of Discrepancy, attached to the FLD dated August 15, 2014, the deficiency income tax assessment of ₱12,206,739.18, inclusive of interest, resulted from the disallowance by the BIR of the following reported cost of sales as deductions in computing the 5% income tax liability of petitioner for FY ended October 3, 2009, to wit:[6]

Item of Expense	**Amount in USD**
1. Repairs & Maintenance	$1,861,447.00
2. Data Processing	673,186.00
3. Insurance	284,503.03
4. Outside Services	141.29
Total	$2,819,277.32

7. On September 12, 2014, through R.G. Manabat & Co., petitioner duly filed its protest[7] dated September 11, 2014 against the FAN and FLD.[8]

---

[5] Par. 5, Summary of Admitted Facts, JSFI, Court Docket, pp. 170-171; Exhibit "P-5", Court Docket, p. 220; Exhibit "R-5", BIR Records, p. 309.
[6] Par. 6, Summary of Admitted Facts, JSFI, docket, p. 171.
[7] Exhibit "P-8", Court Docket, pp. 237-244.
[8] Pars. 6 and 7, Summary of Admitted Facts, JSFI, Court Docket, p. 171.

8. The BIR issued a Final Decision on Disputed Assessment[9] (FDDA) dated June 5, 2015, denying petitioner's protest and supplemental position papers against the deficiency income tax assessment for FY ended October 3, 2009 in the total amount of ₱12,206,739.18, inclusive of interest, for lack of factual and legal bases.[10]

9. The last paragraph of the FDDA provides that:

> xxx This is our final decision. If you disagree, you may appeal this final decision to the Court of Tax Appeal (sic) or to the Commissioner of Internal Revenue through request for reconsideration within thirty (30) days from date of receipt hereof, otherwise our said deficiency income tax assessment shall become final, executory and demandable.[11]

10. In denying the protest of petitioner, the BIR, through the FDDA, reiterated its position in the FAN and FLD, and ruled that:

> xxx The enumerated/listed allowable deductions, under Revenue Regulations No. 11-2005 and Rule XX of the Rules & Regulations to Implement RA 7916 (PEZA), are exclusive under the maxim expressio unius est exclusio alterius, the mention of one thing implies the exclusion of another thing not mentioned, as ruled in BIR Ruling No. 014-12 dated January 4, 2012 of the Commissioner of Internal Revenue. The BIR Ruling No. 014-12 revoked all other existing rulings inconsistent thereto, hence the BIR Rulings you presented were not considered.[12]

11. Petitioner's protest was denied based on:

a. No BIR Ruling was specifically requested nor issued by the BIR to petitioner and it cannot rely on the rulings issued to other taxpayers;

b. Any deduction for income tax purposes, by its nature, is equated to exemption, hence construed strictly against the taxpayer;

---

[9] Exhibit "P-6", Court Docket, pp. 224-227; Exhibit "R-7", BIR Records, pp. 415-418.
[10] Par. 8, Summary of Admitted Facts, JSFI, Court Docket, p. 171.
[11] Par. 9, Summary of Admitted Facts, JSFI, Court Docket, pp. 171-172; Exhibit "P-6", Court Docket, p. 227; Exhibit "R-7", BIR Records, p. 415.
[12] Par. 10, Summary of Admitted Facts, JSFI, Court Docket, p. 172; Exhibit "P-6", Court Docket, p. 224; Exhibit "R-7", BIR Records, p. 418.

c. BIR Ruling No. 14-12 dated January 4, 2012, BIR Ruling No. 081-12 dated February 15, 2012, BIR Ruling No. 112-12 dated February 22, 2012, BIR Ruling No. 140-12 dated February 27, 2012 and BIR Ruling No. 194-13 dated May 21, 2013, all issued by the Commissioner of Internal Revenue, ruled that the list of allowable deductions to arrive at the gross income earned subject to the 5% preferential rate is exclusive;

d. BIR Ruling No. 14-12 dated January 4, 2012 was not considered in the CTA case of *East Asia Utilities Corporation vs. Commissioner of Internal Revenue*; and

e. No retroactivity of ruling can be spoken of insofar as petitioner is concerned as there was no ruling issued specifically in its favor on this issue.[13]

12. Respondent BIR maintains that the enumeration of allowable deductions under the PEZA Law and RR No. 11-2005 is exclusive. Hence, it denied the foregoing direct costs claimed by petitioner as they were not among those explicitly enumerated in Rule XX of the Implementing Rules and Regulations (IRR) of RA No. 7916 and RR No. 11-2005.[14]

13. Through its authorized representative, petitioner received respondent's FDDA on June 5, 2015."[15]

On September 21, 2015, respondent filed his Answer[16] and interposed the following special and affirmative defenses:

"PETITIONER CANNOT RELY ON BIR RULINGS ISSUED UPON REQUEST BY OTHER TAXPAYERS.

5. Petitioner, in the first instance, claims that it may depend on previous BIR Rulings upon which it relied upon in good faith. Let it be stressed however, that it (sic) not disputed that the aforesaid BIR

---

[13] Par. 11, Summary of Admitted Facts, JSFI, Court Docket, pp. 172-173; Exhibit "P-6", docket, p. 226; Exhibit "R-7", BIR Records, p. 416.
[14] Par. 12, Summary of Admitted Facts, JSFI, Court Docket, p. 173.
[15] Par. 13, Summary of Admitted Facts, JSFI, Court Docket, p. 173.
[16] Court docket, pp. 94-98.

Rulings mentioned in the Petition, were not issued in its favor.

6. Clearly, petitioner is remiss from the foregoing argument. It is an elementary rule that a taxpayer cannot rely on BIR Rulings issued upon the request of other taxpayers; logically, because said rulings were issued for the inquiring person's own guidance and clarification as to the nature of tax and how it is applied to it, or its transactions.

7. Furthermore, the foregoing BIR Rulings are not general interpretative rules issued by respondent; to the contrary these are private rulings at the request of an inquiring taxpayer. At the risk of being repetitive, respondent maintains petitioner cannot rely of (sic) rulings issued to other taxpayers.

8. Similarly, the doctrine of operative fact has no application in this case. In the *Taganito Case* cited by petitioner, "there must be a rule or ruling issued by the Commissioner that is relied upon by the taxpayer in good faith." As previously discussed, it is beyond contestation that petitioner has no BIR Ruling issued in its favor, but instead, baselessly relied on another's BIR Ruling. Accordingly, its argument, that BIR Ruling No. 014-12 should only be applied prospectively, must fail.

THE ENUMERATION OF ALLOWABLE DEDUCTIONS IN RULE XX OF THE IMPLEMENTING RULES AND REGULATIONS OF RA NO. 7916 AND RR NO. 11-2005 ARE (sic) EXCLUSIVE.

9. Tax exemptions are limited to those granted by law.

10. In the case of *Commissioner of Internal Revenue v. Isabela Cultural Corporation,* G.R. No. 172231 dated February 12, 2007, the Supreme Court held that: *am*

> "Corollarily, it is the governing principle in taxation that tax exemptions must be construed in *strictissimi juris* against the taxpayer and liberally in favor of the taxing authority; and one who claims an exemption must be able to justify the same by the clearest grant of organic or statute law.

11. Similarly, in the case of *Commissioner of Internal Revenue v. Julieta Ariete*, G.R. No. 164152 dated January 21, 2010, citing CIR v. CA 338 Phil 322, 330 (1997), the Supreme Court also held that "the general rule of requiring adherence to the letter in construing statutes applies with particular strictness to tax laws and <u>provisions of a taxing act are not to be extended by implication</u>."

12. In this case, petitioner seeks the inclusion of certain expenses as allowable deductions under RR 11-2005 and Rule XX of the Rules and Regulations to Implement RA 7916.

13. However, it is clear from the foregoing law and regulation that the items sought to be allowed as deductions are not included therein, for purposes of computing its taxable income subject to the 5% preferential tax rate.

14. In *Commissioner of Internal Revenue v. American Express International, Inc.*, G.R. No. 152609 dated June 29, 2005, the Supreme Court declared that, "though vested with the power to interpret the provisions of the Tax Code, and not bound by predecessor's acts or rulings, the Bureau of Internal Revenue Commissioner may render a different construction to a statute only if the interpretation is in congruence with the law. Otherwise, no amount of interpretation can ever revoke, repeal or modify what the law says."

15. Respondent's interpretation under BIR Ruling No. 014-12, disallowing items not included in the enumeration under RR 11-2005 and Rule XX of the Rules and Regulations to Implement RA 7916, is consistent with the said law and regulation under the

principle of strict interpretation and *Expressio Unius Est Exclusio Alterius.* Accordingly, under her authority to reverse and/or modify its previous rulings, the present interpretation corrected (sic) prevented injustice to the government.

16. At this juncture, it must be stressed that when assessments are assailed, the burden of proof is upon the complaining party. It is incumbent upon the complaining party to show that the assessment was erroneous, in order to relieve himself from it.

17. Failure to present proof of error in the assessment will justify judicial affirmation of said assessment *(Delta Motors Co. vs. Commissioner, CTA Case No. 3782, 21 May 1986; Commissioner of Internal Revenue vs. Court of Appeals, et al., G.R. Nos. 104151 and 105563, 10 March 1995)."*

Thereafter, a Notice of Pre-Trial Conference[17] was issued by the Court on September 22, 2015, setting the case for pre-trial conference on October 15, 2015, but later reset to November 26, 2015 [18], upon respondent's motion [19]. Accordingly, petitioner's Pre-Trial Brief[20] was filed on October 7, 2015, while respondent's Pre-Trial Brief[21] was filed on October 9, 2015.

Pre-Trial Conference ensued. Thereafter, the parties submitted their JSFI[22] on December 18, 2015. On January 19, 2016, the Court issued a Pre-Trial Order[23] approving and adopting the parties' joint stipulations and terminating the pre-trial.

During trial, petitioner presented its Finance Manager, Mr. Richard P. Villarico, as its lone witness.[24] Petitioner formally

---

[17] Court Docket, pp. 100-101.
[18] Order dated October 13, 2015, Court Docket, p. 148.
[19] Motion to Defer Pre-Trial Conference filed on October 9, 2015, Court docket, pp. 143-145.
[20] Court Docket, pp. 127-136.
[21] Court Docket, pp. 137-145.
[22] Court Docket, pp. 169-174.
[23] Court Docket, pp. 182-185.
[24] Minutes of the Hearing dated February 10, 2016, Court Docket, p. 201; Exhibit "P-11", Court Docket, pp. 105-113; Exhibit "P-12", Court Docket, pp. 190-194.

offered Exhibits "P-1" to "P-12",[25] which were all admitted in evidence, except for Exhibit "P-4", in the Resolutions[26] dated March 29, 2016 and June 1, 2016.

On June 27, 2016, petitioner filed a Manifestation with Tender of Excluded Evidence[27], which was noted by the Court in the Resolution[28] dated August 5, 2016.

On the other hand, respondent presented Revenue Officer Meliza C. Wepee as his lone witness.[29] Respondent formally offered Exhibits "R-1" to "R-8-1",[30] which were all admitted in evidence in the Resolution[31] dated December 2, 2016.

This case was declared submitted for decision on January 12, 2017, considering the filing of the petitioner's Memorandum[32] on November 22, 2016 and respondent's Memorandum[33] on January 9, 2017.[34]

ISSUES

The parties submitted the following issues[35] for this Court's disposition:

1. Whether the allowable deductions enumerated in Rule XX of the IRR of RA No. 7916 and RR No. 11-2005 are exclusive.

2. Whether petitioner is liable to pay the assessed amount of ₱12,206,739.18 as deficiency income tax for FY ended October 3, 2009.

---

[25] Formal Offer of Evidence filed on February 19, 2016, Court Docket, pp. 202-207.
[26] Court Docket, pp. 260-261 and pp. 318-319, respectively.
[27] Court Docket, pp. 320-325.
[28] Court Docket, p. 338.
[29] Minutes of the Hearing dated October 10, 2016, Court Docket, p. 349; Exhibit "R-8", Court Docket, pp. 152-158.
[30] Formal Offer of Evidence filed on October 10, 2016; Court Docket, pp. 343-347.
[31] Court Docket, pp. 373-374.
[32] Court Docket, pp. 357-370.
[33] Court Docket, pp. 375-382.
[34] Court Docket, p. 384.
[35] Submitted Issues for Trial, JSFI, Court Docket, p. 173.

Petitioner's Arguments

Petitioner posits the theory that the allowable deductions provided under RR No. 11-2005 and Rule XX of the IRR of RA No. 7916 also known as the PEZA law are not exclusive but merely serve as a guide in determining the expenses which can be considered as direct costs that may deducted in computing the 5% Gross Income Tax (GIT) applicable to PEZA-registered enterprises.

Petitioner further contends that the criterion in determining whether the item should be considered as a direct cost is its direct relation to the rendition of the PEZA-registered services, i.e., 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 and therefore deductible notwithstanding that it is not included in the list. It maintains that to rule for the exclusivity of the list under RR 11-25 is to give a limited and narrow interpretation of the PEZA law and would defeat the very purpose of the incentives granted to PEZA-registered enterprises.

In support of the above theory, petitioner relies on the decision of this Court in Division in the case of *East Asia Utilities Corporation vs. CIR* [36] where it ruled that the allowable deductions enumerated under RR No. 11-2005, as amended are not exclusive.

Respondent's Counter-Arguments

Respondent belies the theory of petitioner and asserts that the enumeration of allowable deductions in Rule XX of the IRR of the PEZA law and RR No. 11-2005 is exclusive. He points to the relevant provisions of the IRR of the PEZA law and RR 11-2005 and contends that it is clear that the items sought to be allowed as deductions are not included therein for purposes of computing its taxable income subject to the 5% preferential tax rate.

In addition, respondent insists that petitioner has not adduced substantial evidence to prove that the alleged items are indeed direct costs that are allowed to be deducted to arrive at

---

[36] CTA Case No. 8179, May 21, 2014

the gross income earned on which the 5% preferential tax rate shall be imposed.

RULING OF THE COURT

We agree with the petitioner that the enumeration of the allowable deductions under RR No. 11-2005 and Rule XX of the IRR of the PEZA Law is not exclusive. To support this conclusion, an analytical glimpse of the history of the PEZA law and its IRR relative to the allowable deductions for PEZA registered enterprises is instructive.

The PEZA law (RA No. 7916) and later amended by RA No. 8748 was enacted with the objective of enticing foreign investors to put up businesses in the Philippines. Foremost among the incentives under the PEZA law are the Income Tax Holiday (ITH) granted for a duration of three (3) to (6) years subject to certain conditions and the five percent (5%) preferential gross income tax (GIT) rate, in lieu of all national and local taxes, upon the expiration of the ITH. *Gross income* is defined in Section 2(nn) of Rule I of the IRR of the PEZA Law, as follows:

> SECTION 2. *Definition of Terms.* – xxx
>
> xxx xxx xxx
>
> nn. "*Gross Income*" for purposes of computing the special tax due under Section 24 of the Act refers to <u>gross sales</u> or gross revenues derived from business activity within the ECOZONE, net of sales discounts, sales returns and allowances and <u>minus costs of sales or direct costs</u> but before any deduction is made for administrative expenses or incidental losses during a given taxable period. The allowable deductions from "gross income" are specifically enumerated under Section 2, Rule XX of these Rules. (underscoring supplied)

Section 2 of Rule XX of the IRR of the PEZA Law enumerates the allowable deductions:

> SECTION 2. *Gross Income Earned; Allowable Deductions.* – For purposes of these Rules, Gross Income Earned shall be defined in Section 2(nn), Rule I of these Rules subject to the following allowable deductions for specific types of enterprises: cm

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

To implement the foregoing provisions, the BIR issued RR No. 2-2005 on February 15, 2005 which states:

> 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): (italics ours)

Subsequently, the above provision was amended by RR No. 11-2005 in June 23, 2005, to read as follows:

> 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: (italics ours)

This Court had the occasion to interpret the foregoing difference in the wordings of the RR 2-2005 and the amendatory RR 11-2005 in the case of *Commissioner of Internal Revenue vs. East Asia Utilities Corporation*[37], where the CTA *En Banc* upheld the Court in Division's ruling[38] in the following manner:

---

[37] CTA EB No. 1207, February 3, 2016.
[38] Supra, note 36. *am*

> "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 (sic) 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."

Again in *Commissioner of Internal Revenue vs. Lear Automotive Services (Netherlands) B.V. – Philippine Branch*[39], the Court *En Banc* upheld the Court in Division's ruling that "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 fine, the Court is of the position that RR 11-05 effectively amended the provisions of RR 02-05 where the words "consists only" were deleted and replaced with the words "the following direct costs are included in the allowable deductions xxx". This suggests, as ruled by the Court in the two aforequoted decisions, that the allowable deductions from gross income of PEZA-registered enterprises enumerated in the IRR of the PEZA Law and RR No. 2-2005, as amended by RR No. 11-2005, are not exclusive. If a particular cost or expense is directly related to the PEZA-registered activity, then it should be treated as a direct cost includible in the allowable deductions from the gross income.[40]

In the instant case, the deficiency income tax arose from respondent's disallowance of certain deductions claimed as part of petitioner's cost of sales in the amount of USD2,819,277.32, broken down as follows:

---

[39] CTA EB No. 1346, June 2, 2016.

[40] *Lear Automotive Services (Netherlands) B.V. — Philippine Branch vs. Commissioner of Internal Revenue*, CTA Case Nos. 8421 & 8561, Resolution dated July 29, 2015.

Item of Expense	Amount in USD
1. Repairs & Maintenance	$1,861,447.00
2. Data Processing	673,186.00
3. Insurance	284,503.03
4. Outside Services	141.29
Total	$2,819,277.32

In the FLD/FDDA, respondent explains that the list of allowable deductions under RR No. 11-2005 and Rule XX of the IRR of the PEZA Law, to arrive at the gross income earned subject to the 5% GIT rate, is exclusive. Considering that petitioner's above-listed deductions are not included in the list of allowable deductions, then these deductions were disallowed from petitioner's claimed cost of sales resulting in a higher tax base for the 5% GIT rate. In support of the disallowance, respondent cited BIR Ruling No. 014-12 dated January 4, 2012, which ruled that the enumeration of allowable deductions under Section 2 of Rule XX of the PEZA IRR is exclusive.

Based on the foregoing, the exhibits presented[41] and the parties' stipulations[42], petitioner has established that it is a PEZA registered enterprise and is entitled to the 5% preferential tax rate on its gross income earned pursuant to RA No. 7916, as amended.

Having settled the legal aspect of this case, the Court shall determine whether the expenses (disallowed by respondent) and claimed as part of petitioner's cost of sales are indeed allowable deductions for the purpose of computing the gross income subject to the 5% preferential tax rate. It is imperative to determine whether petitioner was able to prove that the disallowed deductions were directly incurred or are directly related to the manufacture and assembly of the registered products in order to debunk the allegations embodied in the subject assessments.

To prove that the disallowed deductions claimed by petitioner are direct costs of its PEZA-registered activity, petitioner presented its witness, Mr. Richard P. Villarico, to testify on the nature of these costs and expenses, to wit:

---

[41] Exhibits "P-2" and "P-3", Court Docket, pp. 215-216.
[42] Pars. 1 and 2, Summary of Admitted Facts, JSFI, Court Docket, pp. 169-170.

16) Q: Can you discuss the nature of these allowable deductions?

A: **Repairs and Maintenance Expense** – This deduction represents the expenses incurred by MCC-Philippine Branch in connection with the preservation of its specialized machinery and equipment, as well as its manufacturing plant used for its business operations in Baguio City. These machinery, equipment and manufacturing plant are solely used for the manufacturing and assembly of the specialized airline parts produced by MCC-Philippine Branch.

Data Processing Expense – This represents the allocated charge to production incurred by MCC-Philippine Branch in connection with its Moog Business Systems ("MBS"), which is applied by the Moog-Group globally. The MBS is a mechanism designed to monitor the process of production from the time the work commences from a small piece up to the time it is finally assembled into an airplane part. The MBS records all information all throughout the process, including the source and lot number of the raw materials; the machine number, operation number, and the work station where they were done; and also the person who performed the job, as well as the instruction given at that particular segment of the production process. The MBS ensures that in the event for instance of an airplane accident or mishap and the relevant authority of any country is determining the cause of an accident, MCC-Philippine Branch and/or our Head Office will be able to trace, identify, and provide detailed information and records of each and every aircraft part that MCC-Philippine Branch has produced, sold and incorporated in the aircraft. This ability to monitor in detail and the retention of these records and information for at least 10 years is mandatory and non-negotiable with our clients, especially considering that the

> Philippine plant in Baguio manufactures highly specialized aircraft controls.
>
> **Building Insurance Expense** – This represents insurance expenses allocated by MCC-Philippine Branch to the portion of the building, machinery and equipment devoted for the manufacture, assembly, and fabrication of parts and components for use in aerospace and industrial applications, which is the PEZA-registered activity of MCC-Philippine Branch. The portion of the insurance allocated to administrative function, or that portion of the insurance expense not pertaining to actual operation of MCC-Philippine Branch's PEZA registered activity was not claimed as deduction in computing MCC-Philippine Branch's 5% gross income earned.
>
> **Outside Services** – This represents the payments and fees made by MCC-Philippine Branch in connection with the procurement of the appropriate accreditation by the proper authorities (like the civil aeronautics/aviation board) before it is allowed to enter into any transactions with clients and customers. Needless to say, this deduction represents the costs incurred without which no transaction could be consummated and no sales could be generated by the Company.[43]

Records would show that aside from the above testimony of Mr. Villarico, petitioner presented a supplemental letter together with some supporting documents which was prepared and submitted by its external auditor to the BIR on November 11, 2014.[44] In this letter, petitioner, through its external auditor, attempts to convince the revenue officers that the above-mentioned items are all direct costs of petitioner in the pursuit of its PEZA-related activities.

After a review of the statements contained in Exhibit "P-9" and supporting documents attached thereto, we find that the

---

[43] Exhibit "P-11", Court Docket, pp. 109-110.
[44] Exhibit "P-9, Court Docket, pp. 245-251.

costs related to "Repairs and Maintenance" should form part of its costs of sales in the determination of its taxable income subject to the 5% preferential tax rate on gross income earned.

Suppletorily, Section 27 (A) of the 1997 NIRC, as amended, defines *cost of goods manufactured or sold* to include "all costs of production of finished goods, such as raw materials used, direct labor and manufacturing overhead, freight cost, insurance premiums and other costs incurred to bring the raw materials to the factory or warehouse."

Necessarily, from such definition, the criteria used to determine whether the cost or expense is part of the direct cost is its direct relation in the rendition of 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.[45] We find that the costs of expense incurred for the repair and maintenance of petitioner's machinery and other equipment may be classified as direct cost.

As to the other items claimed by petitioner, there was no evidence presented to establish the fact that these deductions are indeed direct costs. Consequently, without submitting documentary evidence to support its claim, the Court cannot ascertain the nature of these deductions.

It must be emphasized that to be entitled to a tax deduction, the taxpayer must competently establish the factual and documentary bases of its claim.[46] Deductions for income tax purposes partake of the nature of tax exemptions; hence, if tax exemptions are strictly construed, then deductions must also be strictly construed.[47] Corollary to this rule is the principle that when a taxpayer claims a deduction, he must point to some specific provision of the statute in which that deduction is authorized and must be able to prove that he is entitled to the deduction which the law allows.[48]

In sum, we provide below the computation of petitioner's basic deficiency income tax liability for FY ended October 3, 2009, taking into consideration the evidence we have considered above, thus:

---

[45] East Asia Utilities Corporation vs. Commissioner of Internal Revenue, CTA Case No. 8179, May 21, 2014.

[46] *H. Tambunting Pawnshop, Inc. vs. Commissioner of Internal Revenue*, G.R. No. 173373, July 29, 2013.

[47] *Commissioner of Internal Revenue vs. General Foods, (Phils.) Inc.*, G.R. No. 143672, April 24, 2003.

[48] *H. Tambunting Pawnshop, Inc. vs. Commissioner of Internal Revenue*, G.R. No. 173373, July 29, 2013.

Revenue per Income Tax Return		₱ 3,428,320,610.00
Less: Adjusted Cost of Goods Sold	₱ 3,209,377,272.46	
Add: Substantiated Amount of Repairs and Maintenance Expense (*See Schedule 1 below*)	359,512.00	3,209,736,784.46
Gross Profit		₱ 218,583,825.54
Add: Other Income		12,498,078.00
Total Gross Income		₱ 231,081,903.54
Multiply by tax rate		5%
Gross Income Tax Due		₱ 11,554,095.18
Less: Gross Income Tax Paid per Return		
2% Share of Other Agency	₱ 2,069,690.00	
Per BIR Form 1702Q/1702	3,104,535.00	5,174,225.00
Basic Deficiency Income Tax		₱ 6,379,870.18

Schedule 1: Substantiated Amount of Repairs and Maintenance Expense:

Supplier	Invoice		Amount (Net of VAT)	
	Number	**Date**		
Machinebanks' Corporation	112130	March 30, 2009	₱ 92,302.00	[49]
MESCO, Inc.	177353	February 24, 2009	264,860.00	[50]
Nicklaus Machinery Corporation	3917	March 02, 2009	2,350.00	[51]
		Total	**₱ 359,512.00**	

WHEREFORE, premises considered, the instant Petition for Review is hereby **PARTIALLY GRANTED.** Accordingly, the deficiency income tax assessment for fiscal year ended October 3, 2009 is **AFFIRMED WITH MODIFICATIONS**. Petitioner is **ORDERED TO PAY** the amount of **SEVEN MILLION NINE HUNDRED SEVENTY-FOUR THOUSAND EIGHT HUNDRED THIRTY SEVEN PESOS AND SEVENTY-THREE CENTAVOS (₱7,974,837.73)**, inclusive of the twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, computed as follows:

Tax Type	Basic Tax	25% Surcharge	Total
Gross Income Tax (5%)	₱6,379,870.18	₱1,594,967.55	₱7,974,837.73

---

[49] Exhibit "P-9", Court Docket, p. 247.
[50] Exhibit "P-9", Court Docket, p. 248.
[51] Exhibit "P-9", Court Docket, p. 249.

In addition, petitioner is **ORDERED TO PAY**:

(a) Deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency income tax computed from February 15, 2010 until full payment thereof pursuant to Section 249(B) of the NIRC of 1997, as amended; and

(b) Delinquency interest at the rate of 20% per annum on the total amount of ₱7,974,837.73 and on the 20% deficiency interest which have accrued as afore-stated in (a), computed from June 8, 2015 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997, as amended.

SO ORDERED.

CATHERINE T. MANAHAN
Associate Justice

WE CONCUR:

JUANITO C. CASTAÑEDA, JR.
Associate Justice

CAESAR A. CASANOVA
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.
Associate Justice

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's Division.

ROMAN G. DEL ROSARIO
Presiding Justice