REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FILSYN CORPORATION,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 5073

Promulgated:
FEB 03 1997

x - x

DECISION

This is an appeal instituted by the petitioner on the decision of respondent denying its protest on the assessment issued for the first quarter of 1988 in the total amount of P30,585,669.26 corresponding to alleged deficiency Value-added taxes for the period mentioned.

Petitioner is a domestic corporation duly registered as a preferred pioneer enterprise with the Board of Investment as a producer of polyester fibers, filament yarns and bottle grade polyethylene terephthalate resin. It is also a Vat-registered taxpayer under VAT Registration No. 32-4-000584 as of January 1, 1988 (Exhibit "A"). As a registered preferred pioneer enterprise, petitioner has been granted under Republic Act 5186, certain tax exemption privileges from all taxes under the National Internal Revenue Code, except income tax, in the following manner:

100% - January 1, 1980 - December 31, 1984
75% - January 1, 1985 - December 31, 1987
50% - January 1, 1988 - December 31, 1989
20% - January 1, 1990 - November 30, 1991
(see Exhibit "B")

Petitioner alleges that it received an assessment notice from respondent for deficiency value added-tax for the first quarter of 1988 in the sum of P30,585,669.26. The details of the assessment are specified hereunder (p. 34, BIR records), thus:

Deficiency Value-Added Tax -1st Quarter 1988

First Quarter

Output tax		P8,639,075.00
Less: Input tax per return	P33,672,060.25	
Less: Unallowable PIY	P10,868,502.71	
Domestic purchase of taxable goods 1,083,097.52 (50%)	541,548.76	
Importations 7,740,566.33 (50%)	3,870,283.16	18,391,725.62
Total	P15,280,334.63	
Balance carried to succeeding quarter		P 9,752,650.62
Less: Balance carried to succeeding quarter per return		25,032,985.25
Deficiency		P15,280,334.63
Add: 25% surcharge		3,820,083.66
20% interest from 4/21/88 to 4/21/91		11,460,250.97
compromise penalty		25,000.00
TOTAL AMOUNT DUE AND COLLECTIBLE		P30,585,669.26

Petitioner duly protested this assessment in a letter, dated February 25, 1992, and received by respondent on February 27, 1992 (Exhibit "D"). In this letter, petitioner asked for a re-investigation of its alleged tax liabilities and volunteered to present documents to justify the total amount of its inventories which was partly the reason for the VAT deficiency as assessed by the examiners of respondent.

Respondent denied the protest in a letter received by the petitioner on February 8, 1994, declaring therein that petitioner's failure to present pertinent documents to controvert the subject assessment led to the eventual denial of the protest. Consequently, petitioner made an appeal to this Court on March 10, 1994 praying for the cancellation of the assessment for the period corresponding to the first quarter of 1988.

Respondent averred the following special and affirmative defenses, thus:

> 4. Respondent's disallowances of a portion of petitioner's claim for 8% presumptive input tax in the amount of P10,868,502.71 and the 50% of the input tax credit for the first quarter of 1988 was in accordance with Section 105 as implemented by Section 17 of Revenue Regulations No. 5-87, which reads:
>
>> "SEC. 105. Transitional input tax credits. -A person who becomes liable to value-added tax or any person who elects to be a VAT-registered person shall, subject to the filing of an inventory as prescribed by regulations, be allowed input tax on his beginning inventory of goods, materials and supplies equivalent to 8% of the value of such inventory on the actual value-added

tax on such goods, materials and supplies whichever is higher, which shall be creditable against the output tax."

and Section 17, Revenue Regulations No. 5-87 implementing Section 105 of the Tax Code, provides:

SEC. 17.-Presumptive tax on beginning inventories-

(a) xxx xxx xxx;

(b) xxx xxx xxx.

VAT-registered persons also engaged in exempt transactions or services under Section 103(a), (b), (c) and (f) who shall volunteer to be covered by the value-added tax system by filing an application for any of his exempt activities shall be entitled to a presumptive input tax equivalent to 8% of the value of the inventory on hand as of the beginning of the month following the approval of his application consisting of goods for resale in their present condition, materials for further processing, finished goods that have been manufactured by him, goods in process, and supplies, all of which must be directly attributable to the activity that is registered or actual value-added tax paid on such inventory, whichever, is higher."

5. Petitioner's claim for input tax credit is allowable only for input taxes corresponding to the taxable portion of its sales during the period involved.

6. Respondent's tax assessment is prima facie correct and it behooves petitioner to prove the contrary (Interprovincial Autobus Co., Inc. vs. Collector of Internal Revenue, G.R. No. L-6741, January 31, 1959, 98 Phil. 290; Comm. of Int. Rev. vs. Avelino, G.R. No. L-17715, July 31, 1963, 85 SCRA 572).

The issue which faces this Court in this case is whether or not petitioner should be made to pay the deficiency value-added taxes inclusive of increments in the total sum of P30,585,669.26 for the first quarter of 1988. Corollary to this issue is the question of whether or not Section 12 of Revenue Regulation No. 5-87 also known as the VAT Implementing Regulations, shall apply to the present status of petitioner as a preferred pioneer enterprise registered with the Board of Investment.

The deficiency value-added tax stemmed from respondent's disallowance of input tax credit which originated from two sources, namely, the 8% presumptive input tax (PIT) granted under Section 105 of the Tax Code and the input taxes paid by petitioner on its domestic purchases and importations made during the first quarter of 1988. Respondent justified these disallowances by invoking the provision found in Section 12 and 17 of Revenue Regulation No. 5-87.

Section 12 of RR 5-87 provides the following:

> SEC. 12. Apportionment of input taxes between taxable and exempt operations. - If a VAT-registered person is also engaged in other activities, the input taxes paid for purchases of goods and services which cannot be directly attributed to either operation shall be allocated between the VAT taxable operation and the other exempt operation. For this purpose, the amount of VAT taxable sales or receipts over the total sales/receipts multiplied by the total input tax paid during the quarter that

> cannot be directly attributed to either operation shall be the creditable input tax.

Section 17 of the same Revenue Regulation, provides the following:

> SEC. 17. Presumptive tax on beginning inventories.
>
> xxx xxx xxx
>
> VAT-registered persons also engaged in exempt transactions or services under Section 13 (a), (b), (c) and (f) who shall volunteer to be covered by the value-added tax system by filing an application for any of his exempt activities shall be entitled to a presumptive input tax equivalent to 8% of the value of the inventory on hand as of the beginning of the month following the approval of his application consisting of goods for resale in their present condition, materials for further processing, finished goods that have been manufactured by him, goods in process, and supplies, all of which must be directly attributable to the activity that is registered or actual value-added tax paid on such inventory, whichever is higher.

From the above-quoted provisions, respondent concluded that petitioner erred in applying the amount of P13,759,088.07 representing the 8% presumptive input tax (PIT) based on the gross amount of the inventory submitted by the petitioner in the sum of P171,988,604.12. It is the opinion of respondent that only a portion of the value of the inventory is allowable for the purpose of computing the 8% PIT and that the allowable portion is also subject to apportionment or allocation at the rate of 75% which was the rate enjoyed by the petitioner as a registered preferred pioneer enterprise as of December 1987. To illustrate the theory of respondent, We find it appropriate to cite the examiners' computation of the petitioner's alleged deficiency presumptive input tax, found on page 24, BIR records, thus:

Computation of deficiency presumptive input tax

Total inventories per return	P171,988,604.09
Less: Allowable	144,529,280.96
Unallowable	P 27,459,323.13
8% Presumptive input tax	P 2,196,745.85
Add: 75% Exempt 1987 (P144,529,280.96 X 75% X 8%)	8,671,756.86
Total unallowable PIT	P 10,868,502.71
Add: 25% surcharge	2,717,125.68
20% interest up to 10/20/90	6,792,814.20
Compromise penalty	1,000.00
Total deficiency PIT	P 20,379,442.59

From the same aforecited provisions of Revenue Regulation No. 5-87, respondent likewise disallowed the input tax credit corresponding to petitioner's domestic purchase of taxable goods and importations to the extent of 50% corresponding to the rate of exemption enjoyed by petitioner for the period covering 1988.

In summary, the disallowances resulting in the value-added tax deficiency is due to the theory of respondent that petitioner's claim for input tax credit is allowable only for input taxes corresponding to the taxable portion of its sales during the period involved. As a preferred pioneer enterprise infused with tax benefits, respondent maintains that to apply all the input taxes incurred or paid without apportioning or allocating the tax exempt portion of the input tax is violative of the provisions found in Sections 12 and 17 of Revenue Regulations No. 5-87.

Petitioner disputes the aforementioned theory of respondent and advocates the proposition that the provisions relied upon by respondent is not applicable to BOI-registered enterprises and it is therefore entitled to claim input taxes in full without apportionment or allocation primarily because to apply the same would diminish the exemption privilege granted by Republic Act No. 5186. Secondly, petitioner claims that Section 12 of Revenue Regulation No. 5-87 contemplates of a situation where an enterprise is engaged in both VAT-taxable and VAT-exempt operations making such provision alien to its present status because its sales of goods are in fact subject to VAT as they are not engaged in VAT-exempt operations.

We agree with the petitioner and submit that respondent erred in applying the provision found in Section 12 of Revenue Regulation 5-87 in the computation of petitioner's value-added tax deficiency for the first quarter of 1988.

A close perusal and analysis of the provision in question (Section 12 of Revenue Regulation 5-87), reveals that said section contemplates of a situation where a VAT-registered person is engaged in both taxable and exempt operations and that the input taxes paid in a given period cannot be directly attributed to either operation such that an allocation or apportionment of the input taxes between the VAT taxable operation and the exempt operation is proper to be able to determine the amount of creditable input tax. Basic is the principle that VAT-exempt sales transactions are not entitled to input tax credits as provided in Section 9 (a) of Revenue Regulation 5-87, thus:

> SEC. 9. *Exemptions*-(a) In general. -An exemption means that the sale of goods or service is not subject to value-added tax (output tax). <u>The seller is not allowed any tax credit on VAT (input tax) previously paid.</u> The person making the exempt sale of goods or services shall not separately bill any output tax to his customers because the said transaction is not subject to VAT.
>
> On the other hand, a VAT-registered purchaser of goods or services which are exempt from VAT is not entitled to any input tax on such purchase. x x x x x x x (underscoring supplied)

So in a situation where a VAT-registered person is engaged in a VAT taxable activity and a VAT exempt one, Section 104 of the Tax Code provides the following:

> Section 104 x x x x x x x x.
>
> A vat-registered person who is also engaged in transactions not subject to the value-added tax shall be allowed tax credit as follows:

A) Total input tax which can be directly attributed to transactions subject to value-added tax; and

B) A ratable portion of any input tax which cannot be directly attributed to either activity; xxx (underscoring supplied)

Section 12 of Revenue Regulation 5-87 provides a formula to implement the aforecited section of the Tax Code so as to determine the allowable creditable input tax by apportioning the input tax between the taxable and VAT exempt operation. The example found in Section 12 (RR 5-87) illustrates this point clearly, thus:

> *Example 1*: "A", a VAT-registered person is engaged in the sale of VAT taxable goods and at the same time is also engaged in the restaurant business, which is subject to another kind of tax, in the same business establishment. During the quarter he made sales of goods in the amount of P300,000.00 plus a value-added tax of P30,000.00. The sales of the restaurant amounted to P200,000.00 with a separate percentage tax of P8,000.00 for a total of P208,000.00. During the same quarter, repairs on the building amounted to P50,000.00 plus a value-added tax of P5,000.00 Supplies purchased for common use amounted to P10,000.00 plus P1,000.00 value-added tax. Since the value-added tax of P5,000.00 and P1,000.00 or a total of P6,000.00, cannot be directly attributed to either taxable operation or the non-VAT taxable operation, it should be allocated as follows:

Input tax to VAT taxable operation

Sales on VAT Taxable Operations / Total Sales (VAT Taxable and Non-VAT Taxable)	x	Total Input Tax (From VAT paid on repairs and or purchase of supplies)

or

$$\frac{P300,000.00}{P500,000.00} \times P6,000.00 = P3,600.00$$

The remaining P2,400.00 is input tax corresponding to the non-VAT taxable operations which is computed as follows:

$$\frac{P200,000.00}{P500,000.00} \times P6,000.00 = P2,400.00$$

Total input taxes that cannot be directly allocated	P6,000
Less: Input taxes on non-VAT taxable operation	2,400
Input taxes to VAT taxable operation	P3,600

The input taxes allocated to non-VAT taxable operations should be charged to operations under the following entry:

Dr. Repairs	P2,000	
Supplies	400	
Cr. Input Taxes		P2,400

The above adjustment is necessary if the total input taxes of P6,000 were previously debited to input taxes.

The petitioner in the instant case does not fall into the category aforementioned because the nature of the goods sold by petitioner corporation does not fall within the exempt transactions as specified under Section 103 of the Tax Code, thus:

SEC. 103. *Exempt Transactions.* -The following shall be exempt from the value-added tax:

(a) Sale of nonfood agricultural, marine and forest products in their original state by the primary producer or the owner of the land where the same are produced;

(b) Sale or importation in their original state of agricultural and marine food products, livestock and poultry of a kind generally used as, or yielding or producing foods for human consumption, and breeding stock and genetic material therefor;

Products classified under this paragraph and paragraph (a) shall be considered in their original state even if they have undergone the simple processes of preparation or preservation for the market, such as freezing, drying, salting, smoking or stripping. Polished and/or husked rice, corn grits and raw cane sugar shall be considered in their original state for purposes of this paragraph.

(c) Sale or importation of fertilizers, pesticides and herbicides; chemical for the formulation of pesticides; seeds, seedlings and fingerlings; fish, animal and poultry feeds; and soya bean and fish meals;

(d) Sale or importation of petroleum products (except lubricating oil, processed gas, grease, wax and petrolatum) subject to excise tax imposed under the Title VI;

(e) Sale or importation of raw materials to be used by the buyer or importer himself in the manufacture of petroleum products (except lubricating oil and grease) subject to excise tax;

(f) Printing, publication, importation or sale of books and any newspaper, magazine, review, or bulletin which appears at regular intervals with fixed prices for subscription and sale and which is not devoted principally to the publication of advertisements;

(g) Importation of passenger and/or cargo vessel of more than ten thousand tons, whether coastwise or ocean- going, including engine and spare parts of said vessel, to be used by the importer himself as operator thereof;

(h) Importation of personal and household effects belonging to residents of the Philippines returning from abroad and non-resident citizens coming to resettle in the Philippines: *Provided*, That such goods are exempt from customs duty under the Tariff and Customs Code of the Philippines.

(i) Importation of professional instruments and implements, wearing apparel, domestic animals, and personal household effects except any vehicle, vessel, aircraft, machinery, other goods for use in manufacture and merchandise of any kind in commercial quantity) belonging to persons coming to settle for the first time in the Philippines, for their own use and not for sale, barter or exchange, accompanying such persons, or arriving within ninety days before or after their arrival, upon the production of evidence satisfactory to the Commissioner of Internal Revenue, that such persons are actually coming to settle in the Philippines and that the change of residence is *bona fide*;

(j) Services rendered by persons subject to percentage tax under Title V;

(k) Services by agricultural contract growers and milling for others of palay into rice, corn into grits and sugar cane into raw sugar;

(l) Medical, dental, hospital and veterinary services;

(m) Educational services rendered by private educational institutions, duly accredited by the Department of Education, Culture and Sports, and those rendered by government educational institutions;

(n) Sale by the artist himself of his works of art, literary works, musical compositions and similar creations, or his services performed for the production of such works;

(o) Services performed as actors or actresses, talents, singers and emcees; radio and television broadcasters, choreographers; musical, radio, movie, television and stage directors;

(p) Services performed as professional athletes;

(q) Leasing of real property;

(r) Services performed in the exercise of profession on calling (except customs brokers) subject to the occupation tax under the Local Tax Code, and professional services performed by registered general professional partnerships;

(s) Services rendered by individuals pursuant to an employer-employee relationship;

(t) Services rendered by regional or area headquarters established in the Philippines by multinational corporations which act as supervisory, communications and coordinating centers for their affiliates, subsidiaries or branches in the Asia-Pacific Region and do not earn or derive income from the Philippines;

(u) Transactions which are exempt under special laws or international agreements to which the Philippines is a signatory;

(v) Export sales by persons who are not VAT-registered and;

(w) Sales and/or services performed by persons other than those mentioned in the preceding paragraphs, whose annual gross sales and/or receipts do not exceed the amount prescribed in regulations to be

> promulgated by the Secretary of Finance which shall not be less than P100,000 or higher than P500,000.

The petitioner is in fact taxable for value-added tax on its sales of goods such that input taxes it actually paid and its presumptive input tax, is allowed by law to be credited to its output tax. The fact that the petitioner is a pioneer preferred enterprise granted by law with certain tax incentives does not change the nature of its transactions as they are still liable to pay output tax on their sales of goods. It is only by virtue of these tax incentives that they are liable to pay only a portion of their output tax liability depending upon the rate of tax exemption granted for a particular period. These tax incentives as earlier discussed have been granted to registered pioneer enterprise such as the petitioner, under Republic Act No. 5186, Section 8(a) which provides as follows:

> Sec. 8. *Incentives to a Pioneer Enterprise.* - In addition to the incentives provided in the preceding section, pioneer enterprises shall be granted the following incentives benefits:
>
> (a) *Tax Exemptions.* - Exemption from all taxes under the National Internal Revenue Code, except income tax, to the following extent:
>
> (1) One hundred per cent up to December 31, 1972;
>
> (2) Seventy-five per cent up to December 31, 1975;

(3) Fifty per cent up to December 31, 1977;

(4) Twenty per cent up to December 31, 1979;

(5) Ten per cent up to December 31, 1981.

The aforecited tax exemption privilege was extended by the Board of Investments in favor of the petitioner up to the following extent:

100% January 1, 1980 - December 31, 1984
75% January 1, 1985 - December 31, 1987
50% January 1, 1988 - December 31, 1989
20% January 1, 1990 - November 30, 1991

(see Exhibit "B", p. 54, CTA records)

The foreseen confusion sought to be remedied by the formula enunciated in Section 12 of Revenue Regulation No. 5-87 does not exist in the present case because all input taxes paid by the petitioner are all attributed to VAT taxable operations so there is no need to allocate or apportion the input taxes paid and this holds true even to the 8% presumptive input tax that was utilized by the petitioner for the first quarter of 1988. To hold otherwise will be to render inutile the tax incentives enjoyed by BOI-registered enterprise and if We will adopt the respondent's interpretation then it would appear that a non-BOI registered enterprise would be in a better position than one who has availed of the tax incentives because of the full deductibility of input taxes on its output tax liability. This is a situation that could not possibly be conceived by the lawmakers. On the contrary, the following paragraph of Section 104 of the NIRC, quoted hereunder strengthens our stand that the incentives provided for by the BOI is recognized and respected under the VAT law:

> "In case of tax exempt products of a pioneer enterprise registered with the BOI as of August 1, 1986 are sold domestically to value added tax registered person, the value added tax otherwise due on such products shall also be considered as input tax creditable against his output tax payable."

This provision not only explicitly recognizes that the product of a pioneer enterprise is not subject to VAT but went further to consider the same as if paid by the pioneer enterprise so that the VAT registered enterprise to whom the same is sold can claim it as a creditable input tax.

With respect to the inventories submitted by the petitioner as the basis of the 8% presumptive input tax, respondent disallowed a portion of the same and based the presumptive input tax on the amount of P144,529,280.96 instead of the P171,988,604.09 originally submitted by the petitioner (Exhibit "I", page 3 of BIR records) thus allowing only a total presumptive input tax in the sum of P11,562,342.47. In this regard, We have to agree with respondent because there is a presumption that the findings of the BIR on the inventory as basis of the 8% presumptive input tax is in order in the absence of a contrary evidence from the petitioner. The same is as provided for in Section 26 of Revenue Regulation No. 5-87 which reads in part, thus:

> For purposes of sub-paragraphs (2) and (3) above, an inventory as of December 31, 1987 of such goods showing the quantity, description and amount should be filed with the Revenue District Officer not later than January 31, 1988. The value allowed for income tax purposes on inventories shall be the basis for the computation of the 8%. (Underscoring supplied).

Nevertheless, even if we uphold the disallowed portion of the inventory as declared by the respondent, which resulted in the reduction of the amount of presumptive input tax, petitioner cannot be held liable for any Value Added Tax for the first quarter of 1988 because its input tax credits still far exceed its output tax liability for the said period.

WHEREFORE IN VIEW OF THE FOREGOING, the assessment of alleged deficiency Value Added Tax in the amount of P30,585,669.26 issued by the respondent for the first quarter of 1988 is hereby **CANCELLED** for lack of merit.

SO ORDERED.

RAMON O. DE VEYRA
Associate Judge

I CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals