REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

NEC COMPONENTS PHILIPPINES INCORPORATED,
Petitioner,

- versus -

C.T.A. CASE NO. 6145

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
JUN 03 2002

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DECISION

This case involves a claim for refund and/or issuance of a tax credit certificate in the sum of P3,683,459.01, allegedly representing excess or unutilized input VAT payments for the second and fourth quarters of the taxable year 1998 arising from royalties attributable to petitioner's export sales.

The antecedent facts follow.

Petitioner is a domestic corporation organized and existing under the laws of the Republic of the Philippines, with principal office address at the Light Industry and Science Park 2, Brgys. Real and La Mesa, Calamba, Laguna. It is primarily engaged in the business of designing, engineering, manufacturing and exporting of electronic components, particularly, printed wiring board (PWB) and electromechanical devices (EMD or relays) for export (Pars. 1 & 3, Joint Stipulation of Facts). Petitioner exports approximately 100% of the total production of its electronic components abroad (TSN, February 28, 2001, p. 10).

Petitioner is registered with the Bureau of Internal Revenue (BIR) as a value-added tax (VAT) taxpayer with Certificate of Registration bearing RDO Control No. 96-056-001615 dated April 12, 1996 (Exhibit B). It is likewise registered with Philippine Economic Zone Authority (PEZA) as an Ecozone Export Enterprise pursuant to the provisions of Republic Act No. 7916 with Certificate of Registration No. 96-045 dated April 10, 1996 (Exhibit C).

By virtue of its Registration Agreement with PEZA executed on April 10, 1996 (Exhibit R), petitioner was entitled to a six-year income tax holiday (ITH) effective on the start of its commercial operations or on the date committed in the project proposal, whichever comes earlier.

On May 15, 1996, petitioner and NEC Corporation, a non-resident Japanese corporation, executed two Technical License Agreements (Exhibits D & E) whereby NEC corporation agreed to grant a non-exclusive and non-transferable right and license under know-how to manufacture Licensed Products as enumerated in the Agreements for a fee of five percent (5%) of Net Selling Price. In the said Technical Licensing Agreements, petitioner covenanted to shoulder and pay all taxes, liens and fees which may be levied in the Philippines in connection with the payment of the royalties (Par. 6, Joint Stipulation of Facts). Both agreements were registered with the Department of Trade and Industry on April 1, 1997.

In a letter dated February 3, 1998, petitioner requested for a ruling from the BIR on the tax implication of the royalty payments to NEC Corporation, Japan. The BIR, in response to the request, issued BIR Ruling DA 168-98-4-23-98, which pertinently stated, thus:

> "Additionally, NEC-Japan is liable to a 10% value-added tax (VAT) on the royalties remitted to it by NEC-Philippines. Pursuant to Section 4.102-1(b) of Revenue Regulations No. 7-95, as amended, which provides as follows:
>
> > "The VAT on rentals and/or royalties payable to non-resident foreign corporations or owners for the sale of services and use or lease of properties in the Philippines shall be based on the contract price agreed upon by the licensor and the licensee. The licensee shall be responsible for the payment of VAT on such rentals and/or royalties in behalf of the non-resident foreign corporation or owner by filing a separate VAT declaration/return for this purpose. The duly validated VAT declaration/return is sufficient evidence in claiming input tax credit by the licensee." (Exhibit S; Par. 7, Joint Stipulation of Facts).

On July 24, 1998, petitioner, for and in behalf of NEC-Japan, filed the quarterly VAT return for the second quarter of 1998 and paid the output VAT on the royalties remitted to NEC-Japan in the amount of P2,016,341.89 (Exhibit F; Par. 8, Joint Stipulation of Facts). For the fourth quarter of 1998, petitioner filed the quarterly VAT return for and in behalf of NEC-Japan on January 25, 1999 and paid the output VAT thereon of P1,667,117.16 (Exhibit I; Par. 11, Joint Stipulation of Facts). Likewise, on the same dates of July 24, 1998 and January 25, 1999, petitioner filed its own quarterly VAT returns for the second and fourth quarters of 1998, respectively, declaring the following:

			Input VAT		
Exh.	1998	Zero-rated Sales	Carried-over fr prev quarter	on Domestic Purchases this quarter	Carried-over to the subsequent Quarter
G	2nd qtr	P 218,721,190.35	P 74,276,705.16	P 294,549.47	P 74,571,254.63
J	4th qtr	345,624,366.17	75,113,274.93	158,960.29	75,272,235.22

On July 19, 2000, petitioner simultaneously amended its quarterly VAT returns for the second and fourth quarters of 1998 reporting also the amounts of P2,016,341.89 and

P1,667,117.16, respectively, as input VAT payments on the royalties it remitted to NEC-Japan, thus:

				Input VAT this quarter		
Exh	1998	Zero-rated Sales	Carried-over Fr prev quarter	Domestic Purchases	Royalties	Carried-over to the subsequent Quarter
H	2nd qtr	P218,721,190.35	P 74,279,835.06	P 294,549.47	P 2,016,341.89	P 76,590,726.42
K	4th qtr	345,624,366.17	77,132,109.42	158,960.29	1,667,117.16	78,958,186.87

It is the proposition of the petitioner that its sales for the second quarter of 1998 amounting to P218,721,190.35 and for the fourth quarter in the amount P345,624,366.17, being export sales, qualify for zero-rating under Section 106(A)(2)(a)(1) of the 1997 Tax Code, as amended. Said export sales were paid for in acceptable foreign currency, inwardly remitted and accounted for in accordance with the rules and regulations of the Bangko Sentral ng Pilipinas. Accordingly, it is entitled to a refund/tax credit of the unutilized input VAT attributable to its zero-rated sales pursuant to Section 112(A) of the 1997 Tax Code, as amended.

Consequently, on March 7, 2000, petitioner filed with the DOF One-Stop Shop Inter-Agency Tax Credit and Duty Drawback Center, two separate applications for tax credit/refund of excess input VAT payments on domestic purchases of goods/services for the second quarter of 1998 in the sum of P294,549.47 and P158,960.29 covering the fourth quarter of the same year (Exhibits L, M, N & O).

Subsequently, on July 19, 2000, petitioner through its tax adviser, filed with the One-Stop Shop Inter-Agency Tax Credit and Duty Drawback Center supplemental claims for refund for the second and fourth quarters of 1998 corresponding to the alleged unutilized input VAT payments on royalties remitted to NEC-Japan for the same quarters in the amount of P2,016,341.89 and P1,667,117.16, respectively (Exhibits P, P-1, P-2, Q, Q-1 & Q-2).

Asserting inaction on the part of the respondent, petitioner filed the instant judicial claim on July 21, 2000 but only with respect to the refund and/or issuance of a tax credit certificate of P2,016,341.89 for the second quarter of 1998 and P1,667,117.12 for the fourth quarter of 1998 or the total amount of P3,683,459.01 allegedly representing excess input VAT on royalty payments directly attributable to its zero-rated sales for the same period. Petitioner's alleged excess input VAT payments of P294,549.47 and P158,960.29 on domestic purchases of goods and services for the second and fourth quarters of 1998 were filed under a separate judicial claim docketed as CTA Case No. 6030 (CTA records, page 40).

It must be pointed out at the outset that petitioner's claim for refund with Us is for the amount of P3,683,459.01 whereas its claim with the respondent was for the amount of P3,683,459.05. Whether it was due to typographical error or not, the difference of four centavos (P.04) though negligible may account for the variation of the amounts in this case.

Petitioner's claim is anchored on Section 106(A)(2)(1) in relation to Section 112(A) of the Tax Code, as amended, which We hereunder quote for easy reference:

> "**SEC. 106** – *Value-Added Tax on Sale of Goods or Properties*. –
>
> "(A) *Rate and Base of Tax*. – xxx
>
> xxx xxx xxx
>
> "(2) The following sales by VAT-registered persons shall be subject to zero percent (0%) rate:

"(a) *Export Sales*. – The term '*export sales*' means:

(1) The sale and actual shipment of goods from the Philippines to foreign country, irrespective of any shipping arrangement that may be agreed upon which may influence or determine the transfer of ownership of the goods so exported and paid for in acceptable foreign currency or its equivalent in goods or services, and accounted for in accordance with the rules and regulations of the Bangko Sentral ng Pilipinas (BSP);"

"**SEC. 112**. *Refunds or Tax Credits of Input Tax*. –

"(A) *Zero-rated or Effectively Zero-rated Sales*. – Any VAT-registered person, whose sales are zero-rated or effectively zero-rated may, within two (2) years after the close of the taxable quarter when the sales were made, apply for the issuance of a tax credit certificate or refund of creditable input tax due or paid attributable to such sales, except transitional input tax, to the extent that such input tax has not been applied against output tax: *Provided, however*, That in the case of zero-rated sales under Section 106(A)(2)(a)(1), (2) and (B) and Section 108 (B)(1) and (2), the acceptable foreign currency exchange proceeds thereof had been duly accounted for in accordance with the rules and regulations of the Bangko Sentral ng Pilipinas (BSP)."

To further bolster its case, petitioner submitted voluminous documents and presented witnesses to identify the same.

Respondent, for his part, raised the following Special and Affirmative Defenses, to wit:

"5. Petitioner's alleged claim for refund is subject to administrative routinary investigation/examination by respondent's bureau;

6. Petitioner being allegedly registered with the Philippine Economic Zone Authority, is exempt from all taxes, including valued-added tax, pursuant to Section 24 of Republic Act No. 7916 in relation to Section 103 of the Tax Code, as amended by RA 7716;

6.1) Since petitioner's sales are exempt from VAT, it is not entitled to the refund of input tax pursuant to Section 4.103-1 of Revenue Regulations No. 7-95.

7. Petitioner's claim for tax credit or refund of alleged excess creditable VAT input tax paid for the second quarter of 1998 has already prescribed;

8. Taxes are presumed to have been collected in accordance with law;

9. In an action for refund/credit, the burden of proof is on the taxpayer to establish its right to refund and its failure to sustain the burden is fatal to the claim for refund/credit; and

10. Petitioner must show that it has complied with the provisions of Section 204(c) and 229 of the Tax Code."

However, respondent did not present any evidence to controvert petitioner's allegations and just submitted the case based on the pleadings (CTA records, page 282).

The parties proposed that the issues to be resolved in this case are:

(1) Whether petitioner's sales are exempt from VAT or zero-rated;

(2) Assuming *arguendo* that petitioner's sales are zero-rated, whether or not the alleged VAT input taxes are attributable to zero-rated sales for the 2^{nd} and 4^{th} quarters of the taxable year 1998;

(3) Whether or not the alleged creditable VAT input taxes on royalties of petitioner for the 2^{nd} and 4^{th} quarters of taxable year 1998 are substantiated by documentary evidence; and

(4) Whether or not the said unapplied or unutilized creditable input for the 2^{nd} and 4^{th} quarters of taxable year 1998 were carried over to the succeeding taxable quarter(s) and applied against any output tax liability of the petitioner for the said period.

Before We resolve the above issues in seriatim, We will first determine the issue on the timeliness of the petition as raised by the respondent in his answer, more particularly, the second quarter of 1998.

Section 114(A) of the Tax Code, as amended, provides:

> "Every person liable to pay the value-added tax imposed under this Title shall file a quarterly return of the amount of his gross sales or receipts within twenty-five (25) days following the close of each taxable quarter prescribed for each taxpayer: *Provided, however*, That VAT-registered persons shall pay the value-added tax on a monthly basis."

Records show that petitioner filed both the quarterly VAT return for the second quarter of 1998 for and in behalf of NEC Corporation and its own quarterly return on July 24, 1998 (Exhibits F & G). Applying the provisions of Section 112(A), *supra*, in relation to Sections 114(A) and 229 of the Tax Code, the two-year prescriptive period within which petitioner may apply for the issuance of a tax credit certificate or refund of its creditable input tax must be counted from July 24, 1998. Thus, in the case at bar, petitioner had until July 23, 2000 within which to file its claim for the second quarter of 1998 the year 2000 being a leap year. Clearly, both the administrative and judicial claims for refund filed on July 19, 2000 (Exhibits P, P-1 and P-2) and July 21, 2000, respectively, fall within the two-year prescriptive period.

Proceeding now to the first issue, petitioner was able to prove that its export sales qualify for zero-rating under Sections 106(A)(2)(a)(1), (2), (5) and 106(A)(2)(b) of the 1997 Tax Code.

The fact that petitioner is a VAT-registered entity is undisputed (Exhibit B; par. 4, Stipulated Facts). For the second and fourth quarters of 1998, petitioner generated export sales in the amounts of P218,721,190.35 and P345,624,366.17, respectively, as evidenced by the various export sales invoices, airway bills, export declarations, bills of lading and delivery receipts (Exhibits AA-1 to AA-412 & BB-1 to BB-939) and summarized in the Schedule of Export Sales (Exhibits Y-1 to Y-12). To prove that said export sales were paid for in acceptable foreign currencies inwardly remitted and accounted for in accordance with the rules and regulations of the BSP, petitioner presented the bank certifications (Exhibits CC-1 to CC-16) and bank credit advices (Exhibits DD-1 to DD-227).

Therefore, petitioner's export sales for the second and fourth quarters of 1998 fell under the category of zero-rated export sales under Section 106(A)(2)(a)(1) of the Tax Code. However, as correctly noted by the commissioned auditing firm, SGV & Co., the amounts of P8,066,474.45 (second quarter) and P38,705,450.37 (fourth quarter) pertained to the sales made by petitioner to foreign companies the delivery of which were made locally (mostly to PEZA registered enterprises) as well as sales made/delivered to PEZA registered enterprises (Exhibit W). Nevertheless, petitioner's sales of P8,066,474.45 for the second quarter of 1998 and P38,705,450.37 for the fourth quarter of 1998 are still subject to zero percent VAT for they may be classified as export sales under Section 106(A)(2)(a)(2) and (5) or as foreign currency denominated sales under Section 106(A)(2)(b) of the Tax Code as amended, reproduced below for clarity:

SEC. 106(A)(2)(a)(2)

> "Sale of raw materials or packaging materials to a nonresident buyer for delivery to a resident local export-oriented enterprise to be used in manufacturing, processing, packing or repacking in the Philippines of the said buyer's goods and paid for in acceptable foreign currency and accounted for in accordance with the rules and regulations of the Bangko Sentral ng Pilipinas (BSP)."

SEC. 106(A)(2)(a)(5)

"Those considered export sales under Executive Order No. 226, otherwise known as the Omnibus Investments Code of 1987, and other special laws."

SEC. 106(A)(2)(b)

"*Foreign Currency Denominated Sale*. -

"The phrase 'foreign currency denominated sale' means sale to a nonresident of goods, except those mentioned in Sections 149 and 150, assembled or manufactured in the Philippines for delivery to a resident in the Philippines, paid for in acceptable foreign currency and accounted for in accordance with the rules and regulations of the Bangko Sentral ng Pilipinas (BSP)."

In his memorandum, respondent argues that petitioner, being a PEZA-registered enterprise, is exempt from VAT pursuant to Section 24 of Republic Act (RA) No. 7916, otherwise known as the Special Economic Zone Act of 1995 (PEZA Law), in relation to Section 109 of the Tax Code. Section 24 of RA No. 7916 mandates that PEZA-registered enterprises are subject to 5% tax on gross income in lieu of national and local taxes. On the other hand, Section 109(q) of the Tax Code, provides that transactions that are exempt under special laws are exempt from VAT.

We are not persuaded by respondent's ratiocination.

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. We have already ruled in 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 includes 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 includes 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 (**Commissioner of Internal Revenue vs. SEAGATE Technology Philippines**, CA-GR SP No. 61189, June 18, 2001; **Commissioner of Internal Revenue vs. Cebu Toyo Corporation, CA-GR SP No. 60304, July 6, 2001**).

In the present case, petitioner availed of a six-year income tax holiday effective April 1997 (Exhibit R; TSN, February 28, 2001, p. 19). Hence, it is only exempt from income tax and is still liable to pay other national internal revenue taxes as may be imposed upon it by law. Inasmuch as petitioner is registered as a VAT entity, it is subject to VAT. Nonetheless, as it complied with the requirements for zero- rating of its sales as earlier discussed, petitioner is subject to VAT at zero percent (0%).

Petitioner's export sales for the second and fourth quarters of 1998 being zero rated, it is not liable to pay output VAT thereon. Consequently, petitioner may claim a tax credit or refund of input VAT paid on its purchases of goods, properties or services relative to such zero-rated sales in accordance with Section 4.100-2 of Revenue Regulations No. 7-95, in relation to Section 112(A) of the Tax Code, which partly provides:

> "**SECTION 4.100-2**. *Zero-rated sales*. - A zero-rated sales by a VAT-registered person, which is a taxable transaction for VAT purposes, shall not result in any output tax. However, the input tax on his purchases of goods,

properties or services related to such zero-rated sale shall be available as tax credit or refund in accordance with these regulations."

Thus, We determine whether or not the input VAT paid for the second and fourth quarters of 1998 are attributable to its zero-rated sales.

It is an admitted fact that petitioner is primarily engaged in the business of designing, manufacturing and exporting electronic components, particularly, printed wiring boards and electromechanical devices (Par. 3, Joint Stipulation of Facts). The products covered by the license agreements are EP2 power relays (and any other relays and connectors to be mutually agreed upon by the parties) and printed wiring boards (and any other printed wiring boards to be mutually agreed upon by the parties) (Exhibits D and E). Clearly, the input taxes incurred by the petitioner arising from the royalties paid to NEC Corporation in the manufacture of said products were necessarily connected with its business. It follows that then such input taxes arising from royalties are attributable to petitioner's zero-rated sales. Moreover, based on the records of this case, petitioner had no VAT taxable or exempt sales but only zero-rated export sales (Exhibits G, J, H & K). Therefore, all of its reported input VAT for the second and fourth quarters of 1998 on domestic purchases of goods/services and on royalties remitted to NEC-Japan can only be attributed to its zero-rated export sales for the same period. In the case of **Babcock Hitachi (Phils.), Inc. vs. Commissioner of Internal Revenue and the Court of Tax Appeals, CA-GR SP No. 40703, November 21, 1996**, it was ruled that "where petitioner exports 100% of its products, thus, engaged in purely zero-rated sales, all input taxes incurred on its purchases of goods and services and on capital goods imported or locally purchased are all considered directly attributable to its zero-rated sales."

As to whether or not the alleged creditable VAT input taxes on royalties of petitioner for the second and fourth quarters of 1998 are substantiated by documentary evidence, We rule in the affirmative.

Petitioner's claimed input VAT payments on royalties remitted to NEC-Japan in the amount of P2,016,341.89 for the second quarter of 1998 and P1,667,117.16 for the fourth quarter of 1998 are duly supported by machine validated quarterly VAT returns (Exhibits F & I). These VAT returns constitute sufficient evidence in claiming for input tax credit under Section 4.102-1(b) of Revenue Regulations No. 7-95, to wit:

> "(b) The VAT on rental and/or royalties payable to non-resident foreign corporations or owners for the sale of services and use or lease of properties in the Philippines shall be based on the contract price agreed upon by the licensor and the licensee. <u>The licensee shall be responsible for the payment of VAT on such rentals and/or royalties in behalf of the non-resident foreign corporation or owner by filing a separate VAT declaration/return for this purpose. The duly validated VAT declaration/return is sufficient evidence in claiming input tax credit by the licensee</u>." (Underscoring supplied).

Anent the last issue, petitioner was able to establish that despite the carry-over of the claimed input taxes of P3,683,459.05 in its succeeding quarterly VAT returns up to the first quarter of 1999 (Exhibits K, U & T), the same were not utilized since petitioner had no output VAT liability for the said quarters. In addition, in the 1999 first quarterly VAT return filed by the petitioner (Exhibit T), the input taxes amounting to P3,683,459.05 were included as part of the total amount of P4,963,270.24 deducted as "Any VAT Refund/TCC Claimed" (Line item #24A of Exhibit T) from the "Total Available Input Tax" of P81,573,423.29 (Line item #23 of Exhibit T). The resulting "Excess Input Tax" of P2,615,236.42 (Line item #24B of Exhibit T) to be carried over to the succeeding second quarter of 1999 does not include the claimed input taxes of

P3,683,459.05. Verily, the unapplied input taxes of petitioner for the second and fourth quarters of 1998 amounting to P3,683,459.05 were carried over but remained unutilized and unapplied against any output tax liability of the petitioner for the succeeding quarters (Exhibit T). Furthermore, the input taxes from the previous quarters (2nd quarter of 1996 to 3rd quarter of 1997 and 4th quarter of 1997 to 4th quarter of 1998) amounting to P73,994,916.63 and P4,963,270.24, respectively, were deducted from the total input taxes of petitioner as of the 1st quarter 1999 (Exhibit T). The amount of P4,963,270.24 so deducted included the subject claim of P3,683,459.01. In sum, petitioner did not utilize the input tax subject of this claim in the succeeding second quarter of 1999.

IN THE LIGHT OF ALL THE FOREGOING, the instant petition for review is hereby **GRANTED**. Respondent is **ORDERED** to **REFUND** and/or **ISSUE A TAX CREDIT CERTIFICATE** in favor of the petitioner in the amount of P2,016,341.89 and P1,667,117.12 or the aggregate amount of P3,683,459.01 representing excess or unutilized input VAT payments on royalties remitted to NEC Corporation-Japan for the second and fourth quarters of taxable year 1998. No costs.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

I CONCUR:

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

CERTIFICATION

I hereby certify that the above 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