REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

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COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

- versus -

CLARK WATER CORPORATION,
Respondent.

CTA EB No. 1920
(CTA Case No. 9286)

Present:

DEL ROSARIO, *P.J.*,
CASTAÑEDA, JR.,
UY,
RINGPIS-LIBAN,
MANAHAN,
BACORRO-VILLENA, and
MODESTO-SAN PEDRO, *JJ.*

Promulgated:

FEB 04 2021 2:53 p.m.

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RESOLUTION

UY, J.:

For this Court's resolution is respondent's ***MOTION FOR RECONSIDERATION (RE: DECISION DATED MARCH 12, 2020)*** filed on July 1, 2020,[1] without petitioner's comment despite due notice.[2]

In the said *Motion*, respondent prays for the reversal and setting aside of the Court *En Banc*'s Decision promulgated on March 12, 2020, the dispositive portion of which reads:

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[1] EB Docket, pp. 159 to 174.
[2] Records Verification Report dated December 7, 2020 issued by Record Officer Leocadia D. Victoria, EB Docket, p. 186.

"**WHEREFORE**, in light of the foregoing considerations, the instant *Petition for Review* is **GRANTED.** The Decision dated May 3, 2018 and the Resolution dated August 8, 2018 rendered by the Second Division of this Court, in CTA Case No. 9286 are hereby **REVERSED and SET ASIDE**.

The assessment issued by petitioner against respondent for CY 2011 covering deficiency VAT is **MODIFIED.** Accordingly, respondent is **ORDERED TO PAY** petitioner in the amount of **SEVEN MILLION SIX HUNDRED SIXTY-TWO THOUSAND EIGHT HUNDRED TWENTY-ONE PESOS AND FIFTY-SEVEN CENTAVOS (₱7,662,821.57)** representing deficiency VAT for CY 2011, as follows:

Taxable Sales/Receipts	₱19,827,708.97
Output VAT Rate	12%
Output VAT Due	2,379,325.08
Less: Creditable Input Tax	-
Value Added Tax Due	2,379,325.08
Less: Tax Withheld/Paid per Return	-
Basic Deficiency VAT	2,379,325.08
Add: 25% Surcharge	594,831.27
Sub-Total	**₱2,974,156.35**
20% Deficiency Interest:	
(26-Jan-2012 to 5-Feb-2016[3])	
2,379,325.08 X 20% X 1472/365	1,919,104.94
Total Amount Due, February 5, 2016	**₱4,893,261.28**
20% Deficiency Interest:	
(6-Feb-2016 to 31-Dec-2017)	906,099.14
2,379,325.08 X 20% X 695/365	
20% Delinquency Interest:	
(6-Feb-2016 to 31-Dec-2017)	1,863,461.15
2,974,156.35 X 20% X 695/365	
Total Amount Due, Dec.31, 2017	**₱7,662,821.57**

[3] Division Docket (CTA Case No. 9286) – Vol. 1, 412.

The compromise penalties in the amount of ₱25,000.00 is **CANCELLED.**

In addition, respondent is **ORDERED TO PAY** delinquency interest at the rate of twelve percent (12%) on the total unpaid amount as of February 5, 2016 in the amount of ₱4,893,261.28, as determined above, computed from January 1, 2018 until full payment thereof pursuant to Section 249 (C) of the Tax Code, as amended by RA No. 10963 and implemented by Revenue Regulations No. 21-2018.

SO ORDERED."

Respondent's arguments:

In its *Motion for Reconsideration*, respondent submits that the Court *En Banc* erred in its conclusion that the 5% special tax may only apply to respondent's income from sources within the Clark Freeport Zone (CFZ) even if respondent's income from sources outside the CFZ amounted only to 7.12% of its total sales.

Respondent submits that the strained harmonization of Section 5 and 8 of Department Order (DO) No. 03-08, effectively nullifying the provisions in Section 8, is erroneous and unnecessary. Thus, respondent moves that the Court reverses and sets aside the assailed Decision on the bases of the following grounds:

1) There is no need to harmonize Section 5 and 8 of DO No. 03-08 because they deal with distinct subject matters.

2) It was erroneous for the Court to rely on the provisions of Section 5, DO No. 03-08 as basis for determining whether respondent's income from sources outside the Clark Special Economic Zone are subject to the 5% special tax regime, since this subject matter is specifically governed by Section 8, DO No. 03-08;

3) The Court *En Banc* erred in its conclusion that the definition of Gross Income Earned (GIE) in Section 5, DO No. 03-08 precludes the application of the 5% special tax rate on income generated from sources outside the Ecozone or Freeport Zone.

4) The principle of "technical importation" does not apply to respondent's sales of services within the Customs Territory.

5) Even assuming for the sake of argument that the respondent's sales of services to enterprises within the customs territory are considered "technical importations", the 12% VAT on such technical importation should be collected from the buyer-importer from the customs territory, and not the seller from the Ecozone enterprise.

According to respondent, the Court *En Banc* erred in attempting to harmonize Section 5 and 8 of DO No. 03-08 because the clear provision of Section 8 was rendered inutile. Allegedly, it was not necessary for the Court to harmonize the two provisions because they are not inconsistent with each other. Particularly, Sections 5 and 8 of DO No. 03-08 deal with two distinct subject matters. Section 8 provides the conditions by which an Ecozone or Freeport Enterprise will be qualified to avail of the 5% special tax regime under Section 15 of RA No. 7227 and Section 4 of DO No. 03-08. On the other hand, Section 5 of DO No. 03-08 deals with the manner by which the Ecozone or Freeport Enterprise's gross income shall be calculated for purposes of computing the special 5% tax.

Moreover, respondent avers that the clear intent of the Department of Finance in drafting Section 8 of DO No. 03-08 was to set a limit on the maximum volume of local sales that may be generated by an Ecozone or Freeport Enterprise before it gets disqualified from availing of the 5% special tax regime under RA No. 7227.

On the other hand, Section 5 allegedly treats the manner by which the gross income of Ecozone or Freeport Enterprises shall be calculated for purposes of computing the special 5% tax. This may be gleaned from the detailed enumeration of "cost of sales or direct costs" that shall be allowed as deductions for purposes of calculating the Gross Income Earned (GIE) by the Ecozone or Freeport Enterprise.

In addition, respondent submits that there is no need to reconcile Section 8 with Section 5 given that the import and tenor of Section 8, are clear and unequivocal. Read as a whole, it is evident that the Ecozone or Freeport Enterprise will only be subject to the internal revenue taxes under the Tax Code if it breaches the 30% threshold provided in the first sentence of Section 8.

Given the clear and unequivocal language of Section 8, respondent claims that even petitioner himself has issued various ruling and regulations confirming that the entire sales of an Ecozone or Freeport Enterprise qualify for the 5% preferential tax rate on gross income as long as its sales within the Customs Territory do not breach the 30% threshold, citing Section 3, Q7/A7 of RMC No. 50-2007 and BIR Ruling No. DA-526-06.

Lastly, respondent contends that the definition of GIE provided in Section 5 of DO No. 03-08 refers to the "gross sales or gross revenue derived from business activities within the subject Ecozone or Freeport." On the other hand, Section 8 of the same rule speaks of the "income generated from sources outside the Ecozone or Freeport Zone or within the Customs Territory. Contrary to the conclusion reached by the Court, respondent submits that the "income generated from sources outside the Ecozone or Freeport Zone" may still form part of an Ecozone or Freeport Enterprise's "gross sales or gross revenue derived from business activities within the subject Ecozone or Freeport".

THE COURT *EN BANC'S* RULING

Respondent's *Motion for Reconsideration* lacks merit.

We reiterate that Section 8 of DO No. 03-08 must be read in conjunction with Section 5 of said DO, because it is the basis of the computation and imposition of the Special 5% Tax, to wit:

> "SECTION 5. *The Special Five Percent (5%) Tax on Gross Income Earned (GIE).* –
>
> a. For purposes of implementing the special 5% tax on Gross Income Earned, in lieu of national and local taxes, granted to Ecozone Enterprises and Freeport Enterprises in SSEZ, SFZ, CFZ, PPFZ, and MSEZ, the following **<u>shall apply:</u>**
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> 1. **<u>Gross Income Earned (GIE) shall refer to gross sales or gross revenue derived from business activities within the subject Ecozone or Freeport,</u>** net of sales discounts, sales returns and disallowances minus cost of

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> sales or direct costs but before any deduction for administrative, marketing, selling, and/or operating expenses or incidental losses during a given taxable year. Provided, that, in the case of financial enterprises within freeports, gross income shall include interest income, gains from sales, and other income, net of costs of funds." *(Emphases and Underscoring Supplied)*

The foregoing provision clearly states that the gross income, refers to gross sales or gross revenue **derived from business activities within the subject Ecozone or Freeport**. Paragraph (a) of Section 5 of DO No. 03-08 uses the word "*shall apply*" for purposes of implementing the special 5% tax on GIE in SSEZ, SFZ, CFZ, PPFZ, and MSEZ. It bears stressing that the use of the word "shall" in a statute connotes a mandatory order or an imperative obligation.[4]

Thus, We find that respondent's sales of services which were derived in the Customs Territory are not included in the computation of the special 5% tax on GIE, in lieu of national and local taxes, and the same is subject to 12% VAT under the NIRC of 1997, as amended.

Moreover, Section 15 of Republic Act (RA) No. 7227,[5] as amended by RA No. 9400,[6] provides that the same tax and duty incentives entitled Philippine Economic Zone Authority (PEZA) – registered enterprises are enjoyed by Clark Special Economic Zone (CSEZ) and Clark Freeport Zone (CFZ)– registered enterprises (respondent in this case), to wit:

> "SEC. 15. *Clark Special Economic Zone (CSEZ) and Clark Freeport Zone (CFZ).* – xxx
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> xxx xxx xxx
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> The CFZ shall be operated and managed as a separate customs territory ensuring free flow or movement of goods and capital equipment within, into and exported out

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[4] *Power Sector Assets and Liabilities Management Corp. vs. Commissioner of Internal Revenue,* G.R. No. 198146, August 8, 2017.

[5] An Act Accelerating The Conversion Of Military Reservations Into Other Productive Uses, Creating The Bases Conversion And Development Authority For This Purpose, Providing Funds Therefor and For Other Purposes.

[6] An Act Amending Republic Act No. 7227, As Amended, Otherwise Known As The Bases Conversion And Development Act Of 1992, And For Other Purposes.

of the CFZ, as well as provide incentives such as tax and duty-free importation of raw materials and capital equipment. However, exportation and removal of goods from the territory of the CFZ to the other parts of the Philippine territory shall be subject to customs duties and taxes under the Tariff and Customs Code of the Philippines, as amended, the National Internal Revenue Code of 1997, as amended, and other relevant tax laws of the Philippines.

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Duly registered business enterprises that will operate in the Special Economic Zone to be created shall be entitled to the same tax and duty incentives as provided for under Republic Act No. 7916, as amended: *Provided,* That for the purpose of administering these incentives, the PEZA shall register, regulate, and supervise all registered enterprises within the Special Economic Zones."

Pertinent thereto is Revenue Memorandum Circular (RMC) No. 74-99[7], specifically, Section 5 thereof which deals with the Tax Treatment of Sales Made by a PEZA-Registered Enterprise, to wit:

"SECTION 5. *Tax Treatment of Sales Made by A PEZA Registered Enterprise.* –

1) Sale of goods (i.e., merchandise) by a PEZA-registered enterprise, to a buyer from the Customs Territory (i.e., domestic sales). – xxx

2) Sale of Services by a PEZA Registered Enterprise to a Buyer from the Customs Territory. – This type of transaction is not embraced by the 5% special tax regime governing PEZA-registered enterprises pursuant to RA No. 7916, as implemented by the PEZA rules and regulations hence, such seller

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[7] SUBJECT: Tax Treatment of Sales of Goods, Property, and Services Made by a Supplier from the Customs Territory to a PEZA Registered Enterprise; and Sale Transactions Made by PEZA Registered Enterprises Within and Without the ECOZONE.

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> **shall be subject to the 10% VAT [now 12%], pursuant to Section 108 or to the percentage tax, pursuant to Title V, whichever is applicable, and to the normal income tax on income derived therefrom, pursuant to Title II, NIRC. Such income tax shall be computed in accordance with the method of general apportionment provided in the immediately preceding paragraph.**" *(Emphasis Supplied)*

Paragraph 2 of Section 5 of the foregoing provision categorically mentions that the sale of services by PEZA-registered enterprises to a buyer from the Customs Territory, as in the instant case, is not covered by the 5% special tax regime. Hence, this bolsters the Court's finding that respondent's sales of services which were derived in the Customs Territory are subject to 12% VAT.

Furthermore, RMC No. 50-2007[8] clarified the tax treatment of sale, barter or exchange of goods, properties, or sale or exchange of services made by suppliers from the customs territory to registered freeport zone enterprises, to wit:

> "SECTION 3. Clarificatory Questions and Answers.
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> –
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> Q7: What is the tax treatment for the income of Freeport Zone registered enterprises derived from sources in the Customs Territory?
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> A7: Freeport Zone-registered enterprises may generate income from sources within the Customs Territory of up to thirty percent (30%) of its total income from all sources; provided, that should a Freeport Zone-registered enterprise's income from sources within the Customs Territory exceed thirty percent (30%) of its total income from all sources, then it shall be subject to the income tax laws of the Customs Territory; provided further, that **in any case, custom duties and taxes must be paid with respect to transactions, receipts, income**

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[8] SUBJECT: Tax Treatment of Sale, Barter, or Exchange of Goods or Properties or Sale or Exchange of Services Made by Suppliers From the Customs Territory to Registered Freeport Zone Enterprises in the Subic Freeport Zone (SFZ), the Clark Freeport Zone (CFZ), as well as the Poro Point Freeport Zone (PPFZ), and Vice Versa under Sections 12 and 15 of Republic Act No. 7227, as amended by Republic Act No. 9400.

> **and sales of articles to the Customs Territory and in the Customs Territory.** *(Emphasis Supplied)*

The foregoing explains the tax treatments of the sales within the Customs Territory by Freeport Zone-registered enterprises. The first portion explains the income tax treatment of the sales within the Custom Territory. This tells us that a Freeport Zone-registered enterprises may generate income from sources outside the Ecozone or Freeport Zone or within the Customs territory of up to thirty (30%) of its total income from all sources, and should a Freeport Zone-registered enterprise's income from sources within the Customs Territory exceed thirty percent (30%) of its total income from all sources, it shall be subject to the income tax laws of the Customs Territory.

However, We reiterate that although the provision allows the Ecozone or Freeport Enterprise to generate income from sources outside the Ecozone and Freeport Zone, it does not mean that its income from sources outside the Ecozone or Freeport Zone are outside the subject of the regular 12% VAT under the NIRC.

The second portion of the afore-quoted RMC, states that in any case, customs duties and taxes must be paid with respect to transactions, receipts, income and sales of articles to the Customs Territory and in the Customs Territory. The word "taxes" covers VAT. Thus, this addresses the VAT treatment, that in any case (whether the income is sold within the Freeport Zone or within the Customs Territory), duties and taxes **must be paid with respect to transactions to the Customs Territory and in the Customs Territory**.[9]

From the foregoing, We reiterate that respondent's sales outside the CSEZ (or within the Customs Territory) for Calendar Year 2011 amounting to ₱19,827,708.97 or only 7.12% of the total sales, the same is not exempted from the payment of VAT.

As for the other arguments raised by respondent in the instant motion, the Court *En Banc* finds that the same are mere reiterations or rehash of arguments that the Court *En Banc* have considered,

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[9] Concurring Opinion of Associate Justice Jean Marie A. Bacorro-Villena, EB Docket, p.158.

weighed and resolved in Our assailed Decision. Hence, We shall no longer belabor the discussions therein.

In sum, We find no valid or cogent reason to deviate from our findings and conclusions reached in Our Decision dated March 12, 2020.

WHEREFORE, respondent's *Motion for Reconsideration* is **DENIED** for lack of merit.

SO ORDERED.

ERLINDA P. UY
Associate Justice

WE CONCUR:

(I vote to affirm the assailed Decision and Resolution of the Court in Division)
ROMAN G. DEL ROSARIO
Presiding Justice

Juanito C. Castañeda, Jr.
(I vote to affirm the assailed Decision and Resolution of the Court in Division
JUANITO C. CASTAÑEDA, JR.
Associate Justice

Ma. Belen

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

(I affirm the assailed Decision and Resolution of the Court in Division)
CATHERINE T. MANAHAN
Associate Justice

JEAN MARIE A. BACORRO-VILLENA
Associate Justice

MARIA ROWENA MODESTO-SAN PEDRO
Associate Justice