REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SECOND DIVISION

CLARK WATER CORPORATION, Petitioner,	**CTA Case No. 9286**
	Members:
	CASTAÑEDA, JR., *Chairperson*
-versus-	**CASANOVA**, *and*
	MANAHAN, *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondents.	**Promulgated:** MAY 03 2018 11:30 a.m.

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DECISION

CASANOVA, *J.*:

This resolves the Petition for Review filed by Clark Water Corporation, on March 4, 2016, praying for the cancellation and withdrawal of respondent's assessment for alleged deficiency value-added tax (VAT) for calendar year (CY) 2011 in the total amount of Four Million Nine Hundred Thirty-One Thousand Two Hundred Ninety-Eight Pesos and Sixty-Nine Centavos (P4,931,298.69), inclusive of interests and penalties.

Petitioner is a domestic corporation duly organized and existing under Philippine laws, with registered principal office address at Depot 1901, Bicentennial Hill, Clark Freeport Zone, Clark Field, Pampanga.[1]

Respondent is the duly appointed Commissioner of Internal Revenue (CIR) vested under appropriate laws with the authority to carry out the functions, duties and responsibilities of his Office including

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[1] Par. 1, Supplemental Joint Stipulation of Facts (SJSF) dated November 21, 2016, Docket (Vol. I), p. 352.

inter alia, the power to decide disputed assessments, cancel and abate tax liabilities pursuant to the provisions of the National Internal Revenue Code of 1997 (NIRC), as amended, and other laws, rules and regulations. His principal office is located at the BIR National Office Building, Agham Road, Diliman, Quezon City.

The facts of the case, as jointly stipulated by the parties, are as follows:

Petitioner is authorized by the Securities and Exchange Commission (SEC) to transact business in the Philippines under SEC Registration No. A199915674 dated October 1, 1999.[2]

Petitioner is registered as a Clark Special Economic Zone (CSEZ) enterprise. As such, it is classified as a duly registered CSEZ enterprise engaged in the operation and maintenance of water and sewerage system within the CSEZ.[3]

On August 1, 2014, petitioner received a copy of the respondent's Preliminary Assessment Notice (PAN) assessing the petitioner for deficiency VAT and final withholding tax (FWT) for CY 2011 in the total amount of P24,836,895.45, inclusive of interest, penalties and surcharge.[4]

On August 15, 2014, petitioner filed its reply letter to the PAN.[5]

Petitioner received on September 8, 2014, a copy of respondent's Formal Letter of Demand (FLD) and Final Assessment Notice (FAN) dated August 18, 2014, assessing petitioner of the alleged deficiency taxes for CY 2011 in the total amount of P24,970,553.26, broken down as follows[6]:

Deficiency Value Added Tax		
Taxable Sales/Receipts per Return		P19,827,708.97
Output Tax Due (12%)		2,379,325.08
Less: Creditable Input Tax		-
Value Added Tax Due		2,379,325.08
Less: Tax Withheld/Paid per Return		-
Deficiency Value-Added Tax		2,379,325.08
Add: Surcharge	P 594,831.27	
Interest	1,229,317.96	

[2] Par. 1, Stipulated Facts, Joint Stipulation of Facts and Issues (JSFI) dated September 1, 2016, Docket (Vol. I), p. 208; Exhibit "P-1".
[3] Par. 3, SJSF, Docket (Vol. I), p. 352.
[4] Par. 2, Stipulated Facts, JSFI, Docket (Vol. I), p. 208; Exhibit "P-6".
[5] Last Sentence of Par. 2, Stipulated Facts, JSFI, Docket (Vol. I), p. 208; Exhibit "P-7".
[6] Par. 3, Stipulated Facts, JSFI, Docket (Vol. I), pp. 208-209; Exhibit "P-8".

Compromise Penalty	25,000.00	1,849,149.23	P 4,228,474.30
Deficiency Final Withholding Tax			
Taxable Basis per Return		P48,734,549.75	
Tax Due		14,301,914.12	
Less: Tax Paid/Remittance		642,301.62	
Deficiency Withholding Tax		13,659,612.50	
Add: Interest	P 7,057,466.45		
Compromise Penalty	25,000.00	7,082,466.45	20,742,078.95
TOTAL			**P24,970,553.26**

On October 2, 2014, petitioner filed its protest to the FLD/FAN wherein it requested for the cancellation and withdrawal of the deficiency VAT and FWT assessments for CY 2011.[7]

On February 5, 2016, petitioner received a copy of respondent's Final Decision on Disputed Assessment (FDDA) in which respondent cancelled his deficiency FWT assessment and demanded the payment of deficiency VAT for CY 2011 in the total amount P4,931,298.69, inclusive of interests and penalties.[8]

On March 4, 2016, petitioner filed its Petition for Review.

Within the extension of time granted[9] by the Court, respondent filed his Answer[10] on June 6, 2016, interposing the following Special and Affirmative Defenses, to wit:

> "**SPECIAL AND AFFIRMATIVE DEFENSES**
>
> 4. The foregoing allegations are repleaded and incorporated herein by reference insofar as these are material and applicable.
>
> **A. Sales Transactions/ Services Rendered to A Customer From The Customs Territory Is Subject to Value-Added Tax**
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> 5. Respondent respectfully submits that she properly apprised Petitioner of its value-added tax deficiencies for the taxable year 2011.

[7] Par. 4, Stipulated Facts, JSFI, Docket (Vol. I), p. 209; Exhibit "P-9".
[8] Par. 5, Stipulated Facts, JSFI, Docket (Vol. I), p. 209; Exhibit "P-10".
[9] Order dated May 6, 2016, Docket (Vol. I), p. 138.
[10] Docket (Vol. I), pp. 139-145.

6. It is an admitted fact that Petitioner had sales transactions within the Customs Territory. This item of the assessment was never disputed by Petitioner, both during the administrative and now, judicial protests.

7. With the foregoing, Petitioner banks its position on its alleged entitlement to all incentives available to a CSEZ-registered enterprise particularly the preferential tax rate of 5% in lieu of all national and local taxes.

8. Respondent begs to differ. The preferential tax rate provided under Section 15 of RA 7227, as amended by RA 9400 has no application in the instant case. It is clear from the first phrase thereof that the imposition of the preferential tax rate must not be contrary to 'The provision of **existing law, rules and regulations.**'

9. Accordingly, Section 3 of Revenue Memorandum Circular No. 50-2007 states that:

> Q9: What is the tax treatment of a sale of service or lease of properties (machineries and equipment) by Freeport Zone-registered enterprises to a customer or lessee from the Customs Territory?
>
> **A9: The sale of service shall be exempt from VAT if the service is performed or <u>rendered within the Freeport Zone</u>.**

10. Accurately, Petitioner was assessed of deficiency VAT from its sales transactions **outside** the Clark Freeport Zone Area, as identified by Respondent's revenue officers in its subsidiary tax ledger. The rationale for this was explained in Section 2 of RMC No. 50-2007.

> 'The Philippine VAT Law adheres to the 'cross border doctrine' of the VAT system, which basically means that VAT shall be imposed to form part of the cost of goods destined for consumption outside the territorial border of the Philippine taxing authority. Hence, actual export of goods and services from the Philippines to a foreign country must be free of VAT. **Conversely, those goods destined for use or consumption and <u>services to be rendered within the Philippines shall be subject to the 12% VAT</u>.** In explaining the 'cross border principle', the Supreme Court ruled that (U)nder the cross border principle of the VAT system being enforced by the Bureau of Internal Revenue (BIR), no VAT shall be imposed to form part of the cost of goods destined for consumption outside of the territorial border of the taxing authority. If exports

> of goods and services from the Philippines to a foreign country are free of the VAT, then the same rule holds for such exports from the national territory - except specifically declared areas - to an Ecozone, or in this case, a Freeport Zone. (CIR vs. Seagate and CIR vs. Toshiba; ibid.) -

11. There being no argument that Petitioner rendered services within the Customs Territory, the gross amount of sale must be subject to applicable VAT, as assessed by Respondent.

B. Respondent properly appraised petitioner of its value-added tax deficiencies <u>for the taxable year 2011</u>

12. As previously discussed, Respondent *[sic]* is liable for its deficiency VAT. Respondent also *[sic]* maintains that she imposed the appropriate compromise penalty against Petitioner, pursuant to Revenue Memorandum Order No. 19-2007 and applicable interest and surcharge pursuant to Section 248 and 249 of the 1997 National Internal Revenue Code, as amended.

13. Respondent respectfully submits that, contrary to Petitioner's claim, her assessment of Petitioner's tax deficiencies actually has factual and legal bases.

C. The law heavily presumes upon the favor of the propriety and exactness <u>of tax assessments.</u>

14. Respondent respectfully contends that, as it stands, the deficiency tax liability assessed against Petitioner is proper in all respects, and it is upon Petitioner to establish that the assessment was incorrect or improper.

15. There exists a presumption in favor of the propriety and exactness of the assessment against Petitioner. The Honorable Supreme Court discussed this in the case of Commissioner of Internal Revenue v. Bank of (sic) Philippine Islands,[11] to wit:

> 'xxx xxx xxx

[11] G.R. No. 134062, April 17, 2007.

> Tax assessments by tax examiners are presumed correct and made in good faith. The taxpayer has the duty to prove otherwise. In the absence of proof of any irregularities in the performance of duties, an assessment duly made by a Bureau of Internal Revenue examiner and approved by his superior officers will not be disturbed. All presumptions are in favor of the correctness of tax assessments."'
>
> xxx xxx xxx'

16. Thus, it is upon Petitioner to present evidence and establish the inaccuracy or outright invalidity of the assessment made against it. Corollarily, its failure to do so further confirms the propriety and exactness of the assessment."

On July 7, 2016, the Court conducted the Pre-Trial Conference[12] and ordered the parties to submit their Joint Stipulation of Facts and Issues (JSFI) within twenty (20) days. Respondent's Pre-Trial Brief[13] was filed on July 1, 2016, while petitioner's Pre-Trial Brief[14] was filed on July 7, 2016.

On September 1, 2016, the parties submitted their Joint Stipulation of Facts and Issues,[15] which was approved in Pre-Trial Order[16] dated September 9, 2016.

During trial, petitioner presented[17] its lone witness, Mr. Rolando D. Sumallo, Jr. – petitioner's Finance and Administration Manager.

On November 21, 2016, petitioner filed its Formal Offer of Evidence[18], offering exhibits "P-1" to "P-13-1", inclusive of sub-markings.

On even date, the parties filed a Supplemental Joint Stipulation of Facts[19], which was approved in a Resolution[20] promulgated on December 2, 2016.

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[12] Minutes of the Hearing, Docket (Vol. I), p. 169.
[13] Docket (Vol. I), pp. 155-159.
[14] Docket (Vol. I), pp. 160-168.
[15] Docket, (Vol. I), pp. 208-216.
[16] Docket (Vol. I), pp. 218-221.
[17] Minutes of the Hearing dated October 19, 2016, Docket (Vol. I), p. 345.
[18] Docket, (Vol. I), pp. 355-362.
[19] Docket (Vol. I), pp. 352-354.
[20] Docket (Vol. II), p. 473.

In a Resolution[21] dated December 15, 2016, the Court admitted all exhibits offered by petitioner.

In the hearing[22] held on February 6, 2017, the Court noted respondent's counsel manifestation that respondent will no longer present evidence in view of the submission of the parties' Supplemental Joint Stipulation of Facts and ordered both parties to submit their Memoranda within thirty (30) days, or until March 8, 2017.

After several extension periods granted by the Court, petitioner and respondent filed their Memoranda on April 17, 2017[23] and April 27, 2017[24].

In view of the filing of the aforesaid Memoranda, the instant case was submitted[25] for decision on May 4, 2017.

The parties submitted the following issues[26] for the consideration of the Court:

1. Whether the alleged deficiency VAT for CY 2011 arising from services rendered by petitioner to customers from the customs territory should be cancelled and withdrawn.

2. Whether or not petitioner is liable for interest, surcharge and compromise penalty.

Petitioner mainly argues that as a registered CSEZ enterprise, pursuant to Section 15 of Republic Act No. 7227, Section 5 of Executive Order No. 80 and Proclamation No. 163, it enjoys the preferential tax rate of 5% in lieu of all local and national taxes, unless it breaches the 30% threshold on its sales within customs territory. In this case, petitioner allegedly did not exceed the 30% threshold since its total sales made within the customs territory for calendar year 2011 amounted only to P19,827,638.50 or only 7.12% of petitioner's total revenue for CY 2011. Thus, such sales should not be subject to VAT.

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[21] Docket (Vol. II), pp. 475-476.
[22] Docket (Vol. II), p. 477.
[23] Docket (Vol. II), pp. 497-510.
[24] Docket (Vol. II), pp. 517-523.
[25] Resolution, Docket (Vol. II), p. 524.
[26] II Stipulated Issues for Resolution, JSFI, Docket (Vol. I), p. 210.

To support the foregoing contention, petitioner also cited Section 8 of Department of Finance Order No. 30-08, VAT Ruling No. 043-03, BIR Ruling No. DA-487-03, and BIR Ruling No. DA-526-06 as its legal bases.

On the other hand, respondent argues that petitioner's sales transactions/services rendered to a customer from the customs territory is subject to VAT; that he properly apprised petitioner of its VAT deficiencies for the taxable year 2011; and, that the law presumes the propriety and exactness of tax assessments.

Timeliness of the instant Petition for Review

The Court shall first ascertain if the instant Petition for Review was timely filed.

Pursuant to Section 3, Rule 4 of the 2005 Revised Rules of the CTA, as amended, the CTA has jurisdiction over the following:

> "SEC. 3. Cases within the jurisdiction of the Court in Divisions. – The Court in Divisions shall exercise:
>
> (a) Exclusive original over or appellate jurisdiction to review by appeal the following:
>
> (1) **Decisions of the Commissioner of Internal Revenue in cases involving disputed assessments**, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or other matters arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue;
>
> xxx xxx xxx"

In relation thereto, Section 228 of the 1997 NIRC, as amended, and Section 3.1.4 of Revenue Regulations No. 12-99, as amended, provide that a taxpayer disputing an assessment may appeal to the Court of Tax Appeals within thirty (30) days from the receipt of the CIR's decision on the protest, or from the expiration of the one hundred eighty (180)-day period, granted to the CIR to decide on the protest, otherwise the decision shall become final, executory and demandable.

Considering that the petitioner received the copy of the FDDA on February 5, 2016, it had, therefore, thirty (30) days, or until March 6, 2016, within which to file an appeal with the Court of Tax Appeals. Consequently, the instant Petition for Review was timely filed by petitioner on March 4, 2016.

We shall now resolve the issue on whether the alleged deficiency VAT for CY 2011 arising from services rendered by petitioner to customers from the customs territory should be subject to 12% VAT.

Petitioner's Sale of Services Within The Customs Territory Should Not Be Subject to 12% VAT

Petitioner insists that as a registered CSEZ enterprise, pursuant to Section 15 of Republic Act No. 7227, Section 5 of Executive Order No. 80 and Proclamation No. 163, it enjoys the preferential tax rate of 5% in lieu of all local and national taxes, unless it breaches the 30% threshold on its sales within the customs territory. Accordingly, since its revenues from enterprises located outside the CSEZ territory constituted only 7.12% of petitioner's total revenue for CY 2011, petitioner is of the considered view that its sales within the customs territory should not be subject to VAT.

Respondent, on the other hand, insists that petitioner's sales transactions/services rendered to a customer from the customs territory is subject to VAT pursuant to RMC No. 50-2007.

We find the Petition meritorious.

The below quoted FDDA would clearly show that petitioner is being assessed for its failure to pay the corresponding taxes for the sales of services made outside the CSEZ. The FDDA reads:

Deficiency Value Added Tax		
Taxable Sales/Receipts (See Annex A)		P 19,827,708.97
Output Tax Due (12%)		2,379,325.08
Less: Creditable Input Tax		-
Value Added Tax Due		2,379,325.08
Less: Tax Withheld/Paid per Return		-
Deficiency Value-Added Tax		2,379,325.08
Add: Surcharge	P 594,831.27	
Interest (20% per annum)	1,932,142.34	
Compromise Penalty	25,000.00	2,551,973.61
Total Deficiency Value-Added Tax		**P4,931,298.69**

DETAILS OF DISCREPANCIES

Value-Added Tax

Your company rendered services to customers outside the Clark Freeport Zone area as identified in your subsidiary sales ledger. Following the provisions of RMC 50-2007, the sale of service to the customs territory mandates the service to be subjected to value added tax of 12%. However, considering that your customers were not able to withhold and remit the same, then you must shoulder the VAT on the sale of service since you received the gross amount of sale on the said sale of service pursuant to Section 108(A) of the NIRC".[27]

In Annex A of respondent's FDDA, respondent determined petitioner's alleged deficiency VAT liability in this wise:

"**Sales Outside the CSFZ**

Metered Water Sales	P 16,970,398.68
Waste Water Revenues	2,798,598.64
Installation Fees	6,580.64
Other Misc Revenues	55,190.00
Other Misc Revenues – Sewer	550.00
Penalty Charges	26,391.01
Total Sales Subject to VAT	P 19,827,708.97
	12%
Total Deficiency VAT	P 2,379,325.08"

The foregoing VAT assessment issued against petitioner was anchored on Section 3(Q9/A9) of RMC No. 50-2007, which provides:

"Q9: What is the tax treatment of a sale of service or lease of properties (machineries and equipment) by Freeport Zone-registered enterprises to a customer or lessee from the Customs Territory?

A9: **The sale of service shall be exempt from VAT if the service is performed or rendered within the Freeport Zone.**

The lease of properties, on the other hand, shall likewise be exempt from VAT if the property is located within the

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[27] Exhibit "P-10".

> Freeport Zone. However, if the properties (machineries and equipment) leased by the Freeport Zone-registered enterprise is located outside of the Freeport Zone, payments to such enterprise will be considered as royalties and subject to the final withholding VAT of 12%."

The said provision discussed two things: sale of service and lease of property by a PEZA-registered enterprise. With respect to the lease of property, the BIR distinguished the tax implication of the lease of property, by a PEZA-registered enterprise, to its clients located inside and outside of the Freeport Zone. Accordingly, it shall be exempt from VAT if the property being leased is located within the Freeport Zone, but if the property being leased is located outside of the Freeport Zone, the payment to such enterprise will be considered as royalties and will be subject to 12% final withholding VAT.

As regards the sale of service, no such distinction was made. In fact, the BIR merely stated the tax implication of the sale of service within the Freeport Zone, which, accordingly, is treated as a VAT exempt transaction.

Thus, *We* deem it proper to correlate the afore-quoted provision to Section 3 (Q7/A7) of the same RMC, as the same specifically clarifies the proper tax treatment on income derived by PEZA-registered enterprise within the Customs Territory, to wit:

> Q7: What is the tax treatment for the income of Freeport Zone-registered enterprises derived from sources in the Customs Territory?
>
> 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, 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."

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.
JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairperson, Second Division

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.

ROMAN G. DEL ROSARIO
Presiding Justice

In this case, considering that petitioner is a registered Clark Freeport Enterprise based on its Certificate of Registration and Tax Exemption Clark Business Registration No. C2011-048[28], issued by Clark Development Corporation, it is entitled to enjoy the 5% special tax regime in lieu of national and local taxes, including VAT, so long as its sales within the Customs Territory do not exceed the aforesaid 30% threshold.

Upon review of the records, the Court confirms that in petitioner's Annual Income Tax Return[29] and Audited Financial Statements[30], it had a total revenue of P278,887.00 in CY 2011, while its total sales made within the Customs Territory amounted only to P19,827,638.50, as shown in its Billing Summary for CY 2011. Thus, petitioner is correct in its claim that its revenues from enterprises located outside the Clark Territory amounted only to 7.12% of its total revenue for CY 2011, which was way below the aforesaid 30% threshold. Consequently, following Section 3 (Q7/A7) of RMC No. 50-2007, petitioner's sale of services to its clients within the Customs Territory should not be subject to VAT.

WHEREFORE, the instant Petition for Review is hereby **GRANTED**. The deficiency VAT tax assessment in the total amount of P4,931,298.69 is hereby **CANCELLED** and **WITHDRAWN**.

SO ORDERED.

CAESAR A. CASANOVA
Associate Justice

WE CONCUR:

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

Catherine T. Manahan
CATHERINE T. MANAHAN
Associate Justice

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[28] Exhibit "P-2".
[29] Line 17B of Exhibit P-11".
[30] Exhibit "P-12".