REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

KSS PHILIPPINES, INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 6126

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

NOV 07 2002

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DECISION

This is a claim for refund or issuance of tax credit certificate in the amount of P3,778,238.50 allegedly representing the unutilized input Value-Added Tax (VAT) covering the period from January 1, 1998 to March 31, 1999.

Petitioner is a corporation duly organized and existing under and by virtue of Philippine laws with principal office at the New Cebu Township One, Special Economic Zone, Cantao-an, Naga, Cebu. It is principally engaged in the manufacture and export of surface mounted device quartz crystals used for computers, videotape recorders, television sets and telecommunications equipment *(pars. 1 and 3, Joint Stipulation of Facts and Issues)*.

On February 20, 1997, petitioner registered with the Philippine Economic Zone Authority (PEZA) as an ecozone export enterprise with Certificate of Registration No. 97-016 *(Exhibit A)*. It likewise registered on June 2, 1997 with the Bureau of Internal Revenue

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as a Value-Added Tax (VAT) taxpayer. Its Certificate of Registration bears RDO Control No. 97-083-000614-V and Tax Identification No. 005-037-780 *(Exhibit B)*.

On December 21, 1999, petitioner simultaneously filed with the BIR Revenue District Office No. 83 (Talisay, Cebu) its amended quarterly VAT Returns covering the period from January 1, 1998 until March 31, 1999 *(par. 5, Joint Stipulation of Facts and Issues)*, reflecting excess creditable VAT inputs in the total amount of P3,778,238.50, detailed as follows:

Taxable period	**Exhibit**	**Value-Added Tax (VAT) Inputs**
1998 1st quarter	*C*	P 750,631.14
1998 2nd quarter	*D*	1,095,802.78
1998 3rd quarter	*E*	477,092.80
1998 4th quarter	*F*	25,821.35
1999 1st quarter	*G*	1,428,890.43
Total		P3,778,238.50

On even date, petitioner filed with the same BIR Revenue District Office its application for tax credit certificate of the aforesaid VAT input payments in the amount of P3,778,238.50, citing as legal basis Section 106 of the National Internal Revenue Code of 1977 *(Exhibit H)*.

Due to the inaction of the respondent, petitioner elevated the case to this court on June 29, 2000 through a Petition for Review.

In his Answer filed on August 9, 2000, respondent raised the following Special and Affirmative Defenses, to wit:

> "3. Petitioner's alleged claim for refund is subject to administrative routinary investigation/examination by respondent's Bureau.

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4. Petitioner being allegedly registered with the Philippine Economic Zone Authority, is exempt from all taxes, including, among others, the value-added tax, pursuant to Section 24 of Republic Act No. 7916, in relation to Section 103 of the Tax Code, as amended.

5. Since petitioner's sales are not zero-rated, but are exempt from VAT, it cannot claim for refund of VAT input tax pursuant to Sections 4.106-1 and 4.103-1 of Revenue Regulations No. 7-95.

6. The amount of P3,778,238.50 being claimed by petitioner as alleged excess creditable VAT input tax paid for the period January 1, 1998 to March 31, 1999 was not properly documented.

7. In an action for refund/credit, the burden of proof is on the taxpayer to establish its right to refund and failure to adduce sufficient proof is fatal to the claim for tax refund/credit.

8. Petitioner must show that it has complied with the provisions of Sections 204(C) and 229 of the Tax Code, as amended.

9. Claims for refund are construed strictly against the claimant for the same partake the nature of exemption from taxation (*Commissioner of Internal Revenue vs. Ledesma, 31 SCRA 95)* and as such, they are looked upon with disfavor (*Western Minolco Corp. vs. Commissioner of Internal Revenue, 124 SCRA 121)*."

In their Joint Stipulation of Facts and Issues, the parties submitted the following issues for this court's resolution:

1. Whether or not petitioner's export sales are zero-rated for VAT purposes.

2. Whether or not petitioner incurred VAT input taxes in the total amount of P3,778,238.50 from January 1, 1998 to March 31, 1999.

3. Whether or not the alleged creditable input VAT of petitioner for the period from January 1, 1998 until March 31, 1999 are duly substantiated.

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4. Whether or not petitioner has carried over to the succeeding taxable year/s the alleged creditable input VAT paid for the period from January 1, 1998 until March 31, 1999.

5. Whether or not petitioner is entitled to the refund or tax credit in the total amount of P3,778,238.50.

Before we proceed to the jointly stipulated issues, we shall rule first on the argument raised by respondent in his memorandum that petitioner, being registered with the Philippine Economic Zone Authority (PEZA) as an Ecozone Export Enterprise, is not subject to VAT, pursuant to Section 24 of R.A. 7916, which provides in part, thus:

> **Section 24.** *Exemption from Taxes under the National Internal Revenue Code.*
>
> Any provision of existing laws, rules and regulations to the contrary notwithstanding, no taxes, local and national, shall be imposed on business establishments operating within the ECOZONE. In lieu of paying taxes, five percent (5%) of the gross income earned by all businesses and enterprises within the ECOZONE shall be remitted to the national government. x x x

Based on the foregoing provision, respondent contends that petitioner's business is not subject to VAT or, otherwise stated, it is a non-VAT business, being an ECOZONE or PEZA-registered enterprise. Respondent likewise invoked Section 103(q) [*should be 109(q)*] of the Tax Code, as amended by R.A. 7716, to state:

> **Section 109.** *Exempt Transactions***.** The following shall be exempt from the value-added tax:
>
> x x x
>
> **(q)** Transactions which are exempt under international agreements to which the Philippines is a signatory or under special laws, except those under Presidential Decree Nos. 66, 529 and 1590.

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According to respondent, petitioner is exempt from paying Value-Added Tax (VAT) because the exemption from national and local taxes in Section 24 includes VAT. Consequently, transactions of ECOZONE or PEZA-registered enterprises, being exempt from internal revenue taxes, fall under the phrase "Transactions which are exempt under special laws," under Section 109(q). Respondent further avers that since petitioner's business is not subject to VAT, the capital goods and services it purchased are considered not used in VAT taxable business. Consequently, it is not entitled to the refund of input taxes on such capital goods pursuant to Section 4.106-1 and Section 4.103-1 of Revenue Regulations No. 7- 95, to quote:

> **Section 4.106-1**. *Refunds or tax credits of input tax.-*
>
> x x x
>
> (b.) Capital goods- Only a VAT-registered person may apply for issuance of a tax credit certificate or refund of input taxes paid on capital goods imported or locally purchased. The refund shall be allowed to the extent that such input taxes have not been applied against output taxes. The application should be made within two (2) years after the close of the taxable quarter when the importation or purchase was made.
>
> <u>Refund of input taxes on capital goods shall be allowed only to the extent that such capital goods are used in VAT taxable business. If it is also used in exempt operations; the input tax refundable shall only be the ratable portion corresponding to the taxable operations.</u>
>
> "Capital goods or properties" refer to goods or properties with estimated useful life greater than one year and which are treated as depreciable assets under Section 29 (f), used directly or indirectly in the production or sale of taxable goods or services." (underscoring supplied)

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Upon the other hand, petitioner asserts that it was granted by PEZA a corporate income tax holiday (ITH) incentive for four (4) years from November 1997 to October 2001 *(Exhibit CC).* Thus, considering that during the period of the subject claim, petitioner is indubitably under ITH and is adopting the normal income tax regime (as distinguished from the 5% special tax regime), it is exempt only from income taxes and not from the VAT on its purchases of taxable goods and services. Petitioner also alleges that it is only after the expiration of its ITH incentive that it will start to avail of the 5% special tax regime.

The issue presented is not novel. In the earlier case of *KSS Philippines, Inc. vs. Commissioner of Internal Revenue*, CTA Case No. 5888, promulgated on August 20, 2001, involving the same parties and issues but covering a different period, this court had the occasion to rule on the matter, thus:

> "We agree with the Respondent that if an entity is registered with PEZA as an ecozone enterprise and is remitting 5% of its gross income to the national government, it is exempt from the payment of VAT. However, no evidence was introduced by the Respondent to prove that Petitioner is remitting 5% final tax to the government. What is evident from the records is that Petitioner is a VAT registered entity liable to pay the value-added tax as shown by the registration certificate xxx.
>
> This Court would like to stress that under Section 23 of Republic Act 7916, two different fiscal incentives are granted to an ecozone enterprise, to wit:
>
>> SEC. 23. Fiscal Incentives. – Business establishments operating within the ECOZONE shall be entitled to the fiscal incentives as provided for under the Presidential Decree No. 66, the law creating the Export Processing Zone Authority, **<u>or</u>** those provided for under Book VI of Executive Order No. 226, otherwise known as the Omnibus Investments Code of 1987.

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> Based on the aforequoted Section 23 of RA 7916, a PEZA registered enterprise has the option to choose between two sets of fiscal incentives. One is that which is provided for under Presidential Decree No. 66, as amended and Section 24 of RA 7916 which includes the 5% preferential tax on gross income earned which is in lieu of national and local taxes; and second, as those provided for under Book VI of Executive Order No. 226, including but not limited to an income tax holiday (ITH) of 4 to 6 years depending on whether or not an entity is registered as a pioneer or non-pioneer enterprise. If an ecozone enterprise chooses the 5% preferential tax, it is exempt from payment of all national and local taxes. However, if an ecozone enterprise chooses the income tax holiday, it is only exempt from payment of the income tax but still subject to other national internal revenue taxes including the value-added tax. The difference between these 2 sets of fiscal incentives were explained by the Bureau of Internal Revenue in VAT Ruling Nos. 037-98; 043-98; 027-99; and 063-99 ***(citing Read-Rite Philippines, Inc. (Formerly Sunward Technologies Phils., Inc.) vs. Commissioner of Internal Revenue, CTA Case No. 5659 dated September 29, 2000; Resolution, Seagate Techology (Philippines) vs. Commissioner of Internal Revenue, CTA Case No. 5921, September 20, 2000; Resolution, Cebu Toyo Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5650, August 2, 2000)***.

The aforesaid decision was affirmed in toto by the Court of Appeals in the case entitled ***Commissioner of Internal Revenue vs. KSS Philippines, Inc., CA-G.R. SP No. 66720 dated March 19, 2002***. In its decision, the Court of Appeals explicitly ruled that "(w)hile Sec.103 of the Tax Code specifically excepted from coverage of VAT transactions which are exempted under special laws, those transactions made under Presidential Decree No. 66, among others, are deemed excluded and fall outside the umbrage of the said exemption. Proceeding from the undisputed fact that the respondent company is registered as an ecozone under the provisions of Presidential Decree No. 66, it would be safe to surmise that the latter is not covered by the exemption enumerated under the invoked provision."

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Likewise, in the case of ***Seagate Technology Philippines vs. Commissioner of Internal Revenue, CTA Case No. 5921, September 20, 2000,*** this court, after having been affirmed by the Court of Appeals on June 18, 2001 in ***Commissioner of Internal Revenue vs. Seagate Technology Philippines, C.A. G.R. SP No. 61189***, was likewise affirmed by the Supreme Court in ***Commissioner of Internal Revenue vs. Seagate Technology Philippines, G.R. No. 148523*** in a resolution dated September 5, 2001. In its resolution, the Highest Tribunal interpreted Section 23 of Republic Act 7916 in this wise:

> "Under the aforementioned law, a PEZA registered enterprise has the option to choose between two sets of fiscal incentives. One is that which is provided for under Presidential Decree No. 66, as amended and Section 24 of RA 7916 which includes the 5% preferential tax on gross income earned which is in lieu of national and local taxes; and second, as those provided for under Book VI of Executive Order No. 226, including but not limited to an income tax holiday (ITH) of 4 to 6 years depending on whether an entity is registered as a pioneer or non-pioneer enterprise. If an ecozone enterprise chooses the 5% preferential tax, it is exempt from payment of all national and local taxes. However, if an ecozone enterprise opted for the **income tax holiday**, it is only **exempt from payment of the income tax but still subject to other national internal revenue taxes including the value-added tax**. These were explicitly elucidated by the Bureau of Internal Revenue in VAT Ruling Nos. 037-98; 043-98; 027-99; and 063-99."

It is worth stressing that the respondent failed to introduce any evidence to support his allegation that petitioner is exempt from the value-added tax. Petitioner, however, was able to establish that it enjoyed an income tax holiday during the subject period of the claim, as evidenced by the Certificate of Registration with PEZA dated August 1, 2000 (*Exhibit CC*), the letter from PEZA dated September 20, 2000 (*Exhibit HH*) and its 1998 and 1999 Annual Income Tax Returns (*Exhibits II and JJ*).

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Since petitioner enjoyed the privilege of income tax holiday during the subject years, its export sales, therefore, qualify as zero-rated sales, hence, subject to VAT at zero percent (0%). Accordingly, petitioner may claim for a refund of its unutilized input VAT paid on its domestic purchases of goods and services which are directly attributable to such zero-rated sales as set forth under Section 106(a) [now 112(A)] of the Tax Code, as amended.

Going now to the first issue, this court rules in the affirmative.

Section 106(2)(A) (1) of the Tax Code, as amended provides:

> **Section 106.** *Value-Added Tax on Sale of Goods and Properties.-*
>
> x x x
>
> **(2)** The following sales by a 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 a 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).

That petitioner is a VAT-registered taxpayer is not disputed *(par. 4, Joint Stipulation of Facts and Issues*). And to prove that it exports one-hundred percent (100%) of its total production, petitioner presented as evidence the Quarterly Reports on Operations it submitted to PEZA covering the period of the subject claim which showed that it did not have any local sales and that all of its sales are export sales (*Exhibits KK-5-a, KK-5-b, KK-11-a, KK-11-b, KK-17, KK-23 and KK-29*). Petitioner likewise submitted the certificates of

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inward remittances, export sales invoices, export declarations, airway bills, bills of lading and bank credit notes showing the date of the exportation, the proceeds of the sale which is in acceptable foreign currency, the proceeds of the sale inwardly remitted and the dates of inward remittances. Hence, it is clear to us that petitioner's sales are indeed export sales subject to VAT at zero percent (0 %) rate.

Moreover, as a PEZA-registered export enterprise, petitioner's transactions are explicitly mandated by law to be liable for value-added tax. Section 109 of the 1997 Tax Code provides:

> **Section 109.** *Exempt Transactions.* The following shall be exempt from the value-added tax:
>
> x x x
>
> **(q)** Transactions which are exempt under international agreements to which the Philippines is a signatory or under special laws, except those under Presidential Decree Nos. 66, 529 and 1590.

We do not agree with respondent's construction of the above-cited law that transactions of ECOZONE or PEZA registered enterprises being exempt from internal revenue taxes, under Section 24 of R.A. No. 7916, fall under the phrase " Transactions which are exempt under special laws," which is provided for in Section 109 (q). Respondent did not interpret the whole provision. It failed to apply the proviso "except those under Presidential Decree No. 66," which is the EPZA law and under which the transactions of the petitioner fall. Furthermore, one of the incentives granted to the petitioner by PEZA in its Registration Agreement is VAT zero-rating of local purchases (production related transactions with local suppliers), subject to compliance with BIR and PEZA requirements *(Exhibit CC)*.

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Records show that petitioner had export sales in the total amount of US$6,018,793.30 or Philippine Peso equivalent of P242,266,168.50, covering the period from January 1, 1998 to March 31, 1999 as detailed in the Summary of Export Sales (*Annex B of Exhibit DD*) and supported by various export documents such as export invoices, official receipts, export declarations and airway bills (*Exhibits EE to EE-588 and FF to FF-700*). Out of the total export sales in the amount of US$6,018,793.00, only the sum of US$5,296,484.98 had been verified by the court to have been inwardly remitted to the Philippines or offset against petitioner's payable to its parent company (*Annex B-1 of Exhibit DD*) in accordance with the rules and regulations of the Bangko Sentral ng Pilipinas. The latter amount is broken down as follows:

Inwardly remitted through:		
Fuji Bank, Limited, Manila Branch	US$1,630,986.75	
Bank of the Philippine Islands		
Cebu Mactan EPZA Branch	935,345.40	
Total	US$2,665,092.82	
Less: Debit Memo	152,984.64	US$2,512,108.18
Offset against payables to parent company		2,784,376.80
Total		US$5,296,484.98

As noted, the foreign currency export sales proceeds of US$2,512,108.18 were inwardly remitted through the Fuji Bank, Limited, Manila Branch (*Exhibits GG and GG-7*) and Bank of the Philippine Islands, Cebu Mactan EPZA Branch (*Exhibit GG-8*) as evidenced by the respective banks' certification. There were debit memos for the months of September and October 1998 (*Annex B-1 of Exhibit DD and Exhibits GG–17 to 19*) in the amounts of P134,363.19 and P18,621.45, respectively, or an aggregate amount of P152,984.64, since the total payables to the parent company during the said months were

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higher than the total receivables of the petitioner. The amount of US$2,784,376.80 was offset against petitioner's liabilities to its parent company. It should be noted that petitioner failed to establish proof of inward remittance with respect to the amount of US$722,308.02 (US$6,018,793.00 – US$5,296,484.98). Hence, input taxes attributable to the latter amount should be denied for failure to show that foreign exchange proceeds were actually or constructively remitted.

Anent the second and third issues, the commissioned auditing firm, Punongbayan and Araullo, found that there was an underdeclaration of input VAT claimed per schedule as compared to Input VAT per audit of P11,088.32 and consequently disallowed the amount of P343,034.91 for the following reasons (*Exhibit DD*):

NATURE	AMOUNT
a. Purchase of services from contractors not supported by ORs	P 10,885.24
b. Purchase of luxury car with 2000cc engine displacement	231,972.73
c. Dates of SIs and/or Ors were not within the period covered by the application	60,550.73
d. The printers' BIR permit to print numbers were not indicated in the SIs and/or ORs	34,690.46
e. Amount of input VAT paid indicated in the application is greater than the allowable Input VAT per SIs and/or Ors	2,750.59
f. SIs and/or Ors were not under the name of KSS Philippines, Inc.	1,800.01
g. SIs and/or Ors were not on file	385.15
TOTAL	P343,034.91

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We find the above report of the commissioned independent auditing firm in order.

Moreover, aside from the disallowances of the independent CPA, the court is also constrained to disallow the amount of P750,631.14 input VAT for the 1st quarter of 1998 since the claim is beyond the two-year prescriptive period. The filing of the VAT return which is on the 25th day after the close of each quarter is the reckoning date for the said period. Since petitioner filed its amended its returns on December 21, 1999, it is logical to assume that original returns were also filed before the said date. To facilitate the discussion, a table for analysis is presented below:

		Last day required for filing	Prescribed after
1998	First Quarter	April 25, 1998	April 24, 2000
1998	Second Quarter	July 25, 1998	July 24, 2000
1998	Third Quarter	October 25, 1998	October 24, 2000
1998	Fourth Quarter	January 25, 1999	January 25, 2001
1999	First Quarter	April 25, 1999	April 25, 2001

Based on the table above, the right to claim for the unutilized input VAT for the first quarter of 1998 indubitably prescribed after April 24, 2000. Since the instant petition was filed only on June 29, 2000, the same is clearly time-barred. The rest of the quarters, however, were timely filed.

Proceeding now to the fourth issue, records show that the unutilized input VAT from January 1998 to March 1999 were not carried over to the succeeding taxable quarter as evidenced by its Quarterly VAT Return for the second quarter of 1999 (*Exhibit I, inclusive of submarkings*).

In summary, while we find petitioner entitled to the refund or issuance of tax credit certificate, we cannot grant the full amount claimed because the foreign remittances were not fully substantiated by sufficient evidence and a portion of petitioner's claim has

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prescribed. Thus, we grant petitioner's claim in the amount of P2,372,181.48 computed as follows:

Total Input VAT Claimed		P3,778,238.50
Add: Under declaration of Input VAT Claimed per independent CPA report		11,088.32
Total		P3,789,326.82
Less: Input VAT disallowed per independent CPA report	343,034.91	
Prescribed Input VAT- 1st quarter of 1998	750,631.14	1,093,666.05
Creditable Input VAT		P2,695,660.77
Less: Input VAT related to sales without forex remittance [(US$6,018,793.30 - US$5,296,484.98) / US$6,018,793.30] x P2,695,660.77		323,479.29
Amount to be refunded		P2,372,181.48

WHEREFORE, in view of all the foregoing, the instant petition for review is hereby **PARTIALLY GRANTED.** Accordingly, respondent is hereby **ORDERED** to **REFUND** or **ISSUE A TAX CREDIT CERTIFICATE** in favor of the petitioner in the amount of P2,372,181.48 representing unutilized input value-added tax for the period January 1, 1998 to March 31, 1999.

SO ORDERED.

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

I CONCUR:

Ernesto D. Acosta
ERNESTO D. ACOSTA
Presiding Judge

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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

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