REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

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COMMISSIONER OF INTERNAL REVENUE, *Petitioner,*	**C.T.A. E.B. NO. 75 (C.T.A. CASE NO. 6537)**
	Present:
-versus-	ACOSTA, Presiding Justice, CASTAÑEDA, JR., BAUTISTA, UY, CASANOVA, and PALANCA-ENRIQUEZ, JJ.
BALIUAG DRUG CORPORATION, *Respondent.*	**Promulgated:** JUL 28 2005

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DECISION

PALANCA-ENRIQUEZ, J.:

At odds in the instant case are *Republic Act No. 7432 (RA 7432)*, otherwise known as *"An Act to Maximize the Contribution of Senior Citizens to Nation Building, Grant Benefits and Special Privileges and for Other Purposes"*, specifically *Section 4(a) thereof*, and *Revenue Regulations 2-94 (RR 2-94)*, as to the proper treatment of the 20% sales discounts granted by drugstores to senior citizens on their purchase of medicines. Thus, the question whether or not the sales discounts are to be deductible from gross income as prescribed by *RR 2-94* or treated as a tax credit deductible from the income tax due.

THE CASE

Before Us is a Petition For Review filed by the Commissioner of Internal Revenue (hereafter "petitioner") under *Section 11 of Republic Act No. 9282 (An Act Expanding the Jurisdiction of the Court of Tax Appeals)*, in relation to *Rule 43 of the 1997 Rules of Civil Procedure, as amended*, which seeks the reversal of the Decision dated November 25, 2004 issued by the Second Division in C.T.A Case No. 6537. The assailed Decision was disposed as follows:

> "WHEREFORE, the instant petition is hereby GRANTED. Accordingly, respondent is hereby ORDERED to ISSUE A TAX CREDIT CERTIFICATE in the total amount of P1,085,605.00 in favor of the petitioner representing overpaid income taxes for the taxable years 2000 and 2001 pursuant to Sec. 4(a) of R.A. No. 7432.
>
> SO ORDERED."

Likewise, the Resolution dated March 29, 2005 issued by the same Division of this Court in C.T.A. Case No. 6537, the dispositive portion of which reads as follows:

> "IN VIEW OF THE FOREGOING, We see no cogent and justifiable reason to disturb or modify the aforesaid Decision. Accordingly, respondent's instant motion is hereby DENIED for lack of merit.
>
> SO ORDERED."

THE FACTS

On July 9, 2002 herein respondent filed with petitioner a claim for a tax credit/refund in the total amount of P1,085,605.00 arising from the twenty (20%) percent discount it granted to qualified senior citizens under RA. 7432 on their purchases of medicines during the period from January 1, 2000 to December 31, 2001. Respondent further asserts that Section 2(I) of Revenue Regulations No. 2-94 made an erroneous interpretation of the tax credit provision of the Senior Citizens Law. Respondent's administrative claims were computed as follows (Exhibit "Z"):

TAXABLE YEAR 2000

Sales, Net		P79,215,009.00
Add: Cost of 20% Discount to Senior Citizens		613,425.00
Sales, Gross		79,828,434.00
Less: Cost of Sales		
Merchandise Inventory, Beginning	P11,754,171.00	
Purchases	73,068,396.00	
Merchandise Inventory, Ending	(12,966,783.00)	71,855,784.00
Gross Profit		7,972,784.00
Add: Other Income (net of Interest subject to final tax)		320,391.00
TOTAL INCOME		8,293,041.00
Less: Operating Expenses		6,863,901.00

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NET INCOME BEFORE TAX		1,429,140.00
INCOME TAX (32%)		457,325.00
Less: Income Tax Actually Paid		(273,231.33)
Cost of 20% Discounts To Senior Citizens		(613,425.00)
Income Tax Refundable/Creditable		(429,331.00)

TAXABLE YEAR 2001

Sales, Net		P88,400,736.00
Add: Cost of 20% Discount to Senior Citizens		974,342.00
Sales, Gross		89,375,078.00
Less: Cost of Sales		
Merchandise Inventory, Beginning	P12,966,783.00	
Purchases	81,309,361.00	
Merchandise Inventory, Ending	(14,051,150.00)	80,224,994.00
Gross Profit		9,150,084.00
Add: Other Income (net of Interest subject to final tax)		366,222.00
TOTAL INCOME		9,516,306.00
Less: Operating Expenses		7,914,132.00
NET INCOME BEFORE TAX		1,602,174.00
INCOME TAX (32%)		512,696.00
Less: Income Tax Actually Paid		(194,628.00)
Cost of 20% Discounts To Senior Citizens		(974,342.00)
Income Tax Refundable/Creditable		(656,274.00)
TOTAL INCOME TAX REFUNDABLE		(1,085,605.00)

In his answer filed on October 1, 2002, herein petitioner alleged the following special and affirmative defenses:

> "4. Revenue Regulation No. 2-94 did not alter, modify or amend the intent of the law to consider the 20% discount granted to qualified senior citizen as deduction from petitioner's gross income and not as credit against its tax liability as petitioner insists;
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> 5. With the accumulation of experience and growth of specialized capabilities by the agency charged with implementing a particular statute, it is now a recognized principle that the construction given to a statute by an

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administrative agency charged with the interpretation and application of the statute is entitled to great respect and should be accorded great weight by the courts, unless such construction is clearly shown to be in sharp conflict with the governing statute or the constitution and other laws (Nestle Philippines, Inc. vs. CA, et. al., 203 SCRA 504);

6. R.A 7432 allows the discounts granted to senior citizens to be claimed as a tax credit but is silent as to the mechanics of availing the same. For clarification and as a curative measure, Revenue Regulation No. 2-94 was issued defining the term "tax credit" as used in the law and providing therein the manner of claiming the same, which is by deduction from the establishment's gross income and not from its income tax liability. Otherwise an absurdity, not intended by law, will arise;

7. Petitioner's alleged claim for refund is subject to administrative routinary investigation/examination by the Bureau;

8. The amount of P1,085,605.00 being claimed by petitioner as alleged sales discount to senior citizens on their purchases of medicines for taxable years 2000 and 2001 was not properly documented;

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

10. Petitioner must show that it has complied with the provisions of Sections 204(c) and 229 of the Tax Code on the prescriptive period for claiming tax refund/credit;

> 11. Claims for refund are construed strictly against the claimant for the same partake the nature of exemption from taxation."

After trial on the merits, the Second Division of this Court rendered the assailed Decision on November 25, 2004.

Not satisfied, herein petitioner moved for a reconsideration of the same, which the Second Division denied in the aforesaid Resolution dated March 29, 2005.

Hence, this petition.

ISSUE

Petitioner submits this sole issue for Our consideration:

> WHETHER OR NOT PETITIONER IS ENTITLED TO A TAX CREDIT IN THE AMOUNT OF P1,085,605.00 ALLEGEDLY REPRESENTING OVERPAID INCOME TAXES FOR THE YEARS 2000 AND 2001

On June 7, 2005, We required the respondent to file comment on the petition within ten (10) days from notice, and on June 20, 2005, respondent filed its "Comment (On Petition for Review)".

THE COURT EN BANC'S RULING

The petition has no merit.

The instant petition raised nothing new that We have not settled. The principal issue is centered on the correct interpretation of the language of *RA 7432*, specifically *Section 4 (a)* which provides:

> "Sec 4. Privileges for the Senior Citizens. – The Senior citizens shall be entitled to the following:
>
> a. The grant of twenty percent (20%) discount from all establishments relative to utilization of transportation services, hotels and similar lodging establishments, restaurants and recreation centers and purchase of medicines anywhere in the country; Provided, **That private establishments may claim the cost as tax credit**..." (Emphasis supplied)

In relation to said section, petitioner has consistently maintained that the 20% discount granted to senior citizens should be treated as a deduction from gross income and not as a tax credit deductible from the tax due. The foregoing claim finds support in *RR 2-94* issued by petitioner pursuant to its rule making function. Petitioner, further, stressed that the Senior Citizens Law was not intended to benefit the seller of medicines in the form of claiming the cost of the 20% discount as a deduction from tax due but rather than as a deduction from gross income. If treated as a deduction from gross income, the seller would still benefit from the said law in the form of tax shield equivalent to 32% of the 20% discount granted to qualified senior citizens, 32% being the corporate tax rate, as compared to the outright deduction from tax due equivalent to 100% of the 20% discount granted to qualified senior citizens. Discounts are normally deducted from gross sales in order to arrive at its net sales.

Finally, petitioner concluded his argument with a convenient statement that *RR 2-94* did not alter, modify or amend the intent of the law to consider the 20% discount granted to qualified senior citizens as deduction from gross income and not as credit against tax liability.

We are not persuaded.

This Court in a number of analogous cases has repeatedly ruled otherwise, stating that the 20% sales discounts granted to qualified senior citizens should be treated as a tax credit instead of as a mere deduction from gross income.

Construction Not Availing If Statute Is Clear and Unambiguous

A verbatim reading of *Section 4 of RA 7432* would reveal that the law literally intended the cost of the 20% discount to be claimed as tax credit by establishments. And it is a well settled rule in statutory construction, that when the language of the law is clear and unequivocal, the law must be taken to mean exactly what it says (*Republic vs. Court of Appeals, 299 SCRA 199*).

Time and time again, it has been repeatedly declared by the Supreme Court that where the law speaks in clear and categorical language, there is no room for interpretation but only room for application (*Cebu Portland Cement Co. v. Municipality of Naga, 24 SCRA 708*). The fundamental duty of the court is to apply the law; it may not construe a statute that is clear and free from doubt.

<u>Tax Credit; Defined</u>

Crucial herein is the proper treatment of the tax credit, thus, the need to define and understand its concept. Petitioner advanced his own version as embodied in *RR 2-94, Section 2(i)* which defines tax credit as "the amount representing the 20% discount granted to a qualified senior citizen by all establishments relative to their utilization of transportation services, hotels and similar lodging establishments, restaurants, drugstores, recreation centers, theaters, cinema houses, concert halls, circuses, carnivals and other similar places of culture, leisure and amusement, which discount shall be deducted by the said establishments from their gross income for income tax purposes and from their gross sales for value-added tax or other percentage tax purposes".

We do not agree.

The definition given by petitioner is erroneous. It interpreted tax credit as synonymous to tax deduction, a patent contradiction to its ordinary acceptance. Undeniably, there is a clear distinction between the two terms. The Supreme Court had the opportunity to differentiate the two terms in a very instructive case of *Commissioner of Internal Revenue vs. Central Luzon Drug Corporation, G.R. No. 159647, April 15, 2005,* when it stated:

> "A tax credit differs from a tax deduction. On the one hand, a tax credit reduces the tax due, including – whenever applicable - the income tax that is determined after applying the corresponding tax rates to taxable income. A tax deduction, on the other hand, reduces the income that is subject to tax in order to arrive at taxable income. To think of the former as the latter is to avoid, if not entirely confuse, the issue. A tax credit is used only after the tax has been computed; a tax deduction, before."

Our Tax Code did not specifically provide the definition of a tax credit. Nonetheless, when a statute does not define the word used therein, the courts may consult dictionaries as aid in determining the meaning to be assigned to such word (*Kuenzle & Streiff v. Collector of Customs, 32 Phil. 510*).

Dictionaries generally define words in their natural, plain and ordinary acceptance and significance. As such, courts may adopt the ordinary meaning of the word as defined therein. Thus, consulting *Black's Law Dictionary, 6th edition,* tax credit is defined as "an amount subtracted from an individual's or entity's tax liability to arrive at the total tax liability. A tax credit reduces the taxpayer's liability dollar for dollar, compared to a deduction which reduces taxable income." This definition coincides with the afore-quoted Supreme Court pronouncement.

Invalidity of RR 2-94

Incessantly, petitioner asserts the validity of *RR 2-94* citing the settled rule that construction given to a statute by an administrative agency charged with the interpretation and application of statute is entitled to great respect and should be accorded great weight by the courts (*Nestle Philippines, Inc. v. CA et al., 203 SCRA 504*).

For an administrative regulation to be valid, however, it must not be in contravention but rather it should be in conformity to the standards that

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the law prescribes (*Tayug Rural Bank v. Central Bank, 146 SCRA 120*). Constructions of sort are neither controlling nor binding upon the court, the duty and power to interpret the law being primarily a judicial function. The court may disregard contemporaneous construction, where there is no ambiguity in the law, where the construction is clearly erroneous, where strong reason to the contrary exists, and where the court has previously given the statute a different interpretation (*Statutory Construction 5th Edition, by Ruben E. Agpalo, citing the cases of: Regalado v. Yulo, 61 Phil. 173; Molina v. Rafferty, 37 Phil. 545; Phil. Long Distance Tel. Co. v. CIR, 90 Phil. 674; Chartered Bank Employees Assn. v. Ople, 138 SCRA 273*).

In light of the patent discrepancy in the interpretation, the law should reign supreme over subordinate rules and regulations. Clearly, it was an ultra vires act for petitioner to promulgate *RR 2-94*. He cannot change the intention of the law making body by casually promulgating a subordinate regulation in contravention of the statute it seeks to implement (*Commissioner of Internal Revenue vs. Central Luzon Drug Corporation, supra*)

Inapplicability of Republic Act No. 9257

After all the arguments set forth, petitioner suddenly seeks the application of *Republic Act No. 9257 (hereafter "RA 9257")*, in the instant case. *RA 9257*, otherwise known as the *"Expanded Senior Citizens Act of 2003"*, specifically provides that the discount granted to senior citizens in their purchase of medicines shall be allowed as deduction from gross income, and not as tax credit deductible from tax due, of the establishments which granted the said discount, to wit:

> "Sec. 4. Privileges for the Senior Citizens - The senior citizens shall be entitled to the following:
>
> xxx xxx xxx
>
> The establishment may claim the discount granted under (a),(f),(g) and (h) as tax deduction based on the net cost of the goods sold of services rendered: Provided, that the cost of the discount shall be allowed as deduction from gross income of the same taxable year that the discount is granted. xxx"

We cannot, however, allow the applicability of *RA 9257* in the instant case. The taxable years involved in the instant case were 2000 and 2001, whereas *RA 9257* was approved only on February 26, 2004. It is a well-settled principle in statutory construction that laws operate prospectively, unless the intendment of the legislature to give them a retroactive application is expressly declared or implied from the statute.

Such rule is also embodied in *Article 4 of the Civil Code*, which provides that "laws shall have no retroactive effect, unless the contrary is provided" (*R.E Agpalo, Statutory Construction, 5th edition. 2003, page 352*).

A cursory reading of *RA 9257* does not show the intent of the legislature to apply it retroactively. In fact, *Section 5* of said law clearly provides for its effectivity, to wit: "This Act shall take effect fifteen (15) days after its complete publication in any two (2) national newspapers of general circulation." Therefore, *RA 9257* cannot be applied to the instant case. The twenty (20%) percent discount granted to qualified senior citizens should be treated not merely as a deduction from gross income but as a tax credit, as provided for by *RA 7432,* the applicable law.

Applicable Case Law

Finally, to rest all doubts, the Supreme Court made a categorical ruling on the proper treatment of the tax credit in relation to *Section 4(a) of RA 7432*, to quote:

> "The 20 percent discount required by the law to be given to senior citizen is a tax credit, not merely a tax deduction from the gross income or gross sale of the establishment concerned. A tax credit is used by a private establishment only after the tax has been computed; a tax

deduction, before the tax is computed. RA 7432 unconditionally grants a tax credit to all covered entities. xxx."

Moreover, the Supreme Court went further to state that:

"In the present case, the tax authorities have given the term tax credit in Section 2.i and 4 of RR 2-94 a meaning utterly in contrast to what RA 7432 provides. Their interpretation has muddled up the intent of Congress in granting a mere discount privilege, not a sales discount. The administrative agency issuing these regulations may not enlarge, alter or restrict the provisions of the law it administers; it cannot engraft additional requirements not contemplated by the legislature.

In case of conflict, the law must prevail. A "regulation adopted pursuant to law is law". Conversely, a regulation or any portion thereof not adopted pursuant to law is no law and has neither the force nor effect of law." (*Commissioner of Internal Revenue vs. Central Luzon Drug Corporation, supra.*)

Tax Credit: Fully Substantiated

Having resolved the legal issues, We will now determine whether respondent has presented sufficient evidence to substantiate its claim for refund.

After a careful examination and evaluation of the evidence on record, We find no reason to overturn the factual findings of the Second Division of this Court, which in fine states:

"It should be noted that per Audited Comparative Financial Statements (Exhibit Y) in relation with petitioner's Income Tax Returns for taxable years 2000 and 2001 (Exhibits B and Q), it appears that petitioner had sales discounts of P613,425.00 (Exhibit Y-2-b) and P974,342.00 (Exhibit Y-2-e) for 2000 and 2001, respectively, or in the aggregate sum of P1,587,767.00. However, based on the findings of the commissioned independent CPA, the sales discounts, which were duly substantiated, amounted to P664,760.58 for taxable year 2000 and P1,081,544.85 for taxable year 2001, or for a total sum of P1,746,305.43 which is more than P1,587,767.00, the amount of sales discount reported by petitioner in its financial statements. Hence, We shall only consider the amount P1,587,767.00 sales discounts given to senior citizens since this is the amount reported in petitioner's income statement as well as the amount administratively and judicially claimed by petitioner.

In computing petitioner's 2000 overpaid income tax, it is necessary to add back to petitioner's net sales of P79,215,009.00 (Exhibit Y-2-c) the amount of P613,425.00 representing the 20% sales discounts granted to senior citizens, which was previously deducted from its gross sales, since said discounts are no longer to be treated as deductions from gross income but rather as tax credit.

The same procedure shall likewise be adopted with respect to the computation of petitioner's 2001 overpaid income tax. We shall add back to the net sales of P88,400,736.00 (Exhibit Y-2-f) the amount of P974,342.00 representing the 20% sales discounts granted to senior citizens.

Consequently, a re-computation of petitioner's 2000 and 2001 income tax liabilities using the substantiated amounts of P613,425.00 and P974,342.00, respectively, as allowed tax

> credits will result to an overpaid income taxes of P429,331.00 and P656,274.00 for 2000 and 2001, respectively or a total amount of P1,085,605.00 overpaid income tax for the two taxable years, as correctly computed by petitioner in its administrative claim for refund (Exhibit Z)."

All told, respondent was able to prove its entitlement to refund or tax credit. Conversely, petitioner's assigned error failed in the light of jurisprudence and law.

WHEREFORE, premises considered, the instant petition is hereby **DENIED DUE COURSE**, and, accordingly, **DISMISSED** for lack of merit.

SO ORDERED.

OLGA PALANCA-ENRIQUEZ
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

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

LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, 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.

ERNESTO D. ACOSTA
Presiding Justice