REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC
****

COMMISSIONER OF INTERNAL REVENUE, Petitioner,	**CTA EB No. 1920** (CTA Case No. 9286)
	Present:
- versus -	**DEL ROSARIO,** P.J., **CASTAÑEDA, JR., UY, FABON-VICTORINO, MINDARO-GRULLA, RINGPIS-LIBAN, MANAHAN, BACORRO-VILLENA,** and **MODESTO-SAN PEDRO,** JJ.
CLARK WATER CORPORATION, Respondent.	***Promulgated:*** MAR 12 2020 at 4:09 p.m.

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DECISION

UY, J.:

The instant *Petition for Review* filed on September 17, 2018[1] by the Commissioner of Internal Revenue (CIR) against Clark Water Corporation (respondent), seeks to reverse and set aside the Decision dated May 3, 2018[2] and Resolution dated August 8, 2018[3], both promulgated by the Second Division (Court in Division) of this Court in CTA Case No. 9286, entitled *"Clark Water Corporation, Petitioner, versus Commissioner of Internal Revenue, Respondent,"* the dispositive portions of which respectively read as follows:

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[1] EB Docket, pp. 7 to 17.

[2] Penned by Associate Justice Caesar A. Casanova (now retired), and concurred by Associate Justices Juanito C. Castañeda, Jr., and Catherine T. Manahan, EB Docket, pp. 24 to 35.

[3] *Supra*, EB Docket, pp. 37 to 40.

Decision dated May 3, 2018:

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 The deficiency VAT tax assessment in the total amount of P4,931,298.69 is **CANCELLED** and **WITHDRAWN**.

SO ORDERED."

Resolution dated August 8, 2018:

"**WHEREFORE,** premises considered, respondent's **Motion for Reconsideration Re: Decision dated 3 May 2018** is **DENIED** for lack of merit.

SO ORDERED."

THE FACTS

Petitioner 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 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.

Respondent 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.

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

Respondent 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.

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

On August 15, 2014, respondent filed its *reply* letter to the PAN.

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

Deficiency Value-Added Tax			
Taxable Sales/Receipts per Return (See Annex B)		P 19,827,708.97	
Output Tax Due (12%)		2,379,925.08	
Less: Creditable Input Tax			
Value-Added Tax		2,379,925.08	
Less: Tax Withheld/Paid per Return			
Deficiency Value-Added Tax		2,379,925.08	
Add: Surcharge (25%)	P 594,831.27		
Interest	1,229,317.96		
Compromise Penalty	25,000.00	1,849,149.23	**4,228,474.30**
Deficiency Final Withholding Tax			
Taxable Basis per Audit (See Annex C)		P 48,734,549.75	
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			**P 24,970,553.26**

On October 2, 2014, respondent 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.

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

On March 4, 2016, respondent filed a *Petition for Review* with CTA Court in Division docketed as CTA Case No. 9286, "*Clark Water Corporation, Petitioner vs. Commissioner of Internal Revenue, Respondent.*"

Thereafter, petitioner filed his Answer on June 6, 2016, interposing the following special and affirmative defenses: 1) That sales transactions/services rendered to a customer from the customs territory is subject to VAT; 2) That petitioner properly appraised respondent of its VAT deficiencies for taxable year 2011; and 3) That the law heavily presumes upon the favor of the propriety and exactness of tax assessments.

On July 7, 2016, the Court in Division conducted the Pre-Trial Conference and ordered the parties to submit their Joint Stipulation of Facts and Issues (JFSI) within twenty (20) days. Petitioner's Pre-Trial Brief was filed on July 1, 2016, while respondent's Pre-Trial Brief was filed on July 7, 2016.

On September 1, 2016, the parties submitted their *JSFI,* which was approved in the Pre-Trial Order dated September 9, 2016.

During trial, respondent presented its lone witness, Rolando D. Sumallo, Jr., respondent's Finance and Administration Manager.

On November 21, 2016, respondent filed its *Formal Offer of Evidence,* offering exhibits "P-1" to "P-13-1, inclusive of sub-markings.

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

In the Resolution dated December 15, 2016, the Court in Division admitted all exhibits offered by respondent.

For his part, petitioner manifested that he would not be presenting evidence in CTA Case No. 9286 in view of the submission of the parties' Supplemental JFSI.

As directed by the Court in Division, respondent filed its *Memorandum* on April 17, 2017; while petitioner filed his *Memorandum* on April 27, 2017.

On May 4, 2017, the Court in Division submitted CTA Case No. 9286 for decision.

In the assailed Decision dated May 3, 2018,[4] the Court in Division granted respondent's *Petition for Review*.

Petitioner then filed his *Motion for Reconsideration Re: Decision dated 3 May 2018* on May 18, 2018,[5] to which respondent filed its *Comment (Re: Motion for Reconsideration dated May 18 2018)* on June 25, 2018.[6] In the assailed Resolution dated August 8, 2018,[7] the Court in Division denied petitioner's *Motion for Reconsideration Re: Decision dated 3 May 2018* for lack of merit.

Undaunted, petitioner filed a *Motion for Extension of Time to File Petition for Review* on August 30, 2018.[8] In the Resolution dated September 3, 2018,[9] petitioner was granted a final and non-extendible period of fifteen (15) days from August 31, 2108, or until September 15, 2018, within which to file his *Petition for Review*.

Thereafter, petitioner filed the instant *Petition for Review* on September 17, 2018.[10]

In the Resolution dated October 8, 2018,[11] petitioner was directed to file comment within a period of ten (10) days from notice. On October 29, 2018, respondent filed a *Motion for Extension of Time to File Comment (On Petition for Review dated September 14,*

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[4] EB Docket, pp. 24 to 36; Division Docket (CTA Case No. 9286) – Vol. 2, pp. 528 to 540.
[5] Division Docket (CTA Case No. 9286) – Vol. 2, pp. 541 to 547.
[6] Division Docket (CTA Case No. 9286) – Vol. 2, pp. 553 to 563.
[7] EB Docket, pp. 37 to 40; Division Docket (CTA Case No. 9268) – Vol. 2, pp. 565 to 568.
[8] EB Docket, pp. 1 to 4.
[9] EB Docket, p. 6.
[10] EB Docket, pp. 7 to 17.
[11] EB Docket, pp. 43 to 44.

2018)[12] praying for additional period of twenty (20) days from October 29, 2018 or until November 18, 2018, within which to file its comment.

Subsequently, respondent was granted by the Court in Division a final and non-extendible period of twenty (20) days from October 29, 2018, or until November 18, 2018, within which to file its comment to the Petition for Review.[13]

Thereafter, respondent filed its *Comment (Re: Petition for Review dated September 14, 2018)* on November 19, 2018.[14]

On December 12, 2018, the Court resolved to give due course to the *Petition for Review*, and gave the parties a period of thirty (30) days to file their respective memoranda.[15]

On January 17, 2019, petitioner filed a *Motion for Additional Time to File Memorandum* praying for an additional period of thirty (30) days from January 17, 2019, or until February 16, 2019, within which to file his Memorandum.[16] Thereafter, respondent filed a *Motion for Extension of Time to File Memorandum* on January 18, 2019.[17]

Subsequently, the Court *En Banc* granted both parties' respective motions on January 21, 2019[18] and February 19, 2019[19].

On February 11, 2019, petitioner filed his *Memorandum.*[20] Respondent filed its *Memorandum* on February 18, 2019.[21]

In the Resolution dated March 14, 2019,[22] the instant case was deemed submitted for decision.

Hence, this Decision.

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[12] EB Docket, pp. 45 to 47.
[13] Minute Resolution dated October 31, 2018, EB Docket, p. 49.
[14] EB Docket, pp. 50 to 65.
[15] Resolution dated December 12, 2018, EB Docket, pp. 69 to 70.
[16] EB Docket, pp. 71 to 72.
[17] EB Docket, pp. 76 to 78.
[18] Minute Resolution dated January 21, 2019, EB Docket, p. 80.
[19] Minute Resolution dated February 19, 2019, EB Docket, p. 115.
[20] EB Docket, pp. 81 to 91.
[21] EB Docket, pp. 93 to 113.
[22] EB Docket, pp. 117 to 118.

GROUNDS

Petitioner raises, in his *Petition for Review*, the following grounds to nullify the assailed Decision and Resolution, to wit:

"I.

> LAW, JURISPRUDENCE, AND IMPLEMENTING RULES PROVIDE THAT RESPONDENT'S SALE OF SERVICES OUTSIDE THE ECOZONE ARE SUBJECT TO VALUE-ADDED TAX.

II.

> IN VIOLATION OF THE AFOREMENTIONED LAW, JURISPRUDENCE AND IMPLEMENTING RULES, THE HONORABLE COURT IN DIVISION GRAVELY ERRED IN APPLYING THE 5% PREFERENTIAL TAX TO RESPONDENT'S SALES TRANSACTIONS OUTSIDE THE ECOZONE"[23]

Petitioner's arguments:

Petitioner contends that Republic Act (RA) 7227, as amended by RA 9400 reveals that there is no provision which grants respondent, as a CSEZ-registered enterprise, the exemption from VAT on its sales transactions outside the Clark Special Economic Zone (CSEZ). Allegedly, respondent rendered sales of services outside the Ecozone, such sales are technically considered as importations by the buyers from the Custom Territory and are subject to corresponding taxes under the Tax Code of 1997, including VAT, pursuant to Section 15 of RA 7227, as amended by RA 9400; that the same taxability principle is supported by the Supreme Court in the case of *Commissioner of Internal Revenue vs. Seagate Technology*[24] and amplified in Section 2 of Revenue Memorandum Circular (RMC) No. 50-2007.

Petitioner further contends that the 5% preferential rate as provided under Section 15 of RA 7227, as amended by RA 9400 has no application to the instant case because the subject assessment involves respondent's liability for deficiency VAT on its sales

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[23] EB Docket, p. 9.
[24] G.R. No. 153866, February 11, 2005.

transactions outside the ecozone. According to petitioner, Section 15 of RA 7227, as amended by RA 9400 pertains only to sales transactions within the freeport zone; that it is completely different from sales transactions of a freeport-registered enterprise outside the Ecozone which are always subject to VAT for being treated as importation.

Lastly, on the basis of presumption in favor of the propriety and exactness of tax assessment, petitioner points out that the deficiency tax liability assessed against respondent is proper in all respects, and it is upon respondent to establish that the assessment was incorrect or improper.

Respondent's counter-arguments:

Respondent counter-argues that the deficiency VAT assessment for calendar year 2011 is devoid of any legal or factual basis based on the following:

a) Respondent's sales of services to enterprises within the Customs Territory are covered by the 5% special tax regime and are therefore exempt from VAT;

b) The principle of "technical importation" does not apply to respondent's sales of services within the Customs Territory. Based on 08/A8 of RMC No. 50-2007, the principle of technical importation applies only to the sale of goods and properties by the Freeport Zone-registered enterprises to a buyer from the Customs Territory;

c) Even assuming for the sake of argument that respondent's sales of services to enterprises within the Customs Territory are considered "technical importations", respondent respectfully submits that 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;

d) There is no basis for petitioner's argument that sales of services within the Customs Territory should be subjected to VAT pursuant to the last sentence in Q7/A7 of RMC No. 50-2007.

Finally, respondent argues that the presumption of correctness of assessment does not apply as respondent was able to sufficiently prove that the assessment was issued without legal and factual basis.

THE COURT *EN BANC'S* RULING

The instant *Petition for Review* is meritorious.

Respondent is not exempted from the payment of VAT from its sales of services within the customs territory

Respondent argues that as a registered CSEZ enterprise, it enjoys the preferential tax rate of 5% in lieu of national and local taxes under RA 7227, as amended by RA 9400, unless it breaches the 30% threshold on its sales within customs territory pursuant to Department Order No. (DO) 3-08. Hence, its sales of services within the customs territory are covered by the 5% special tax regime and are therefore exempt from VAT.

Respondent cites Section 15 of RA 7227, as amended by RA 9400 and Section 8 of Department Order (DO) No. 3-08 issued by the Department of Finance, which read as follows:

> "SEC. 15. *Clark Special Economic (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 of the CFZ, as well as provide incentives such as tax and duty-free importation of raw materials and capital equipment. However, exportation or 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.

The provisions of existing laws, rules and regulations to the contrary notwithstanding, **no national and local taxes shall be imposed on registered business enterprises within the CFZ. In lieu of said taxes, a five percent (5%) tax on gross income earned shall be paid by all registered business enterprises within the CFZ** and shall be directly remitted as follows: three percent (3%) to the National Government, and two percent (2%) to the treasurer's office of the municipality or city where they are located:

xxx xxx xxx

Duly registered business enterprises that will operate in the Special Economic Zones 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." *(Emphasis Supplied)*

DO No. 3-08 was issued to implement RA 9400. Section 8 thereof provides:

""SEC. 8 – *Other Tax and Fiscal Obligations* –

A. **If the** Ecozone or **Freeport Enterprise wants to avail of the incentive under the 5% special tax regime, it may generate income from sources outside the Ecozone or Freeport Zone or within the Customs territory up to thirty percent (30%) of its total income from all sources, Provided, however, that if the income of an Ecozone or Freeport exceeds said thirty percent (30%) threshold, then all of its income whether from the Zone or the Customs Territory shall be subject to the relevant internal revenue taxes under the National Internal Revenue Code of 1997, as amended**." *(Emphasis Supplied)*

We do not agree with respondent's argument.

A reading of the above provision shows two scenarios. First, if the Ecozone or Freeport Enterprise wants to avail of the incentives under the 5% special tax regime, it 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 the other is that if the income of an Ecozone or Freeport Enterprises exceeds said thirty percent (30%) threshold, then all of its income whether from the Zone or the Customs Territory shall be subject to the relevant internal revenue taxes under the NIRC of 1997, as amended.

In the instant case, the parties stipulated[25] and as found in the records, the sales of services outside the CSEZ (or within the Customs Territory) for Calendar Year 2011 amounted to ₱19,827,708.97 or only 7.12%[26] of the total sales. The instant case falls under the first scenario.

However, it must be emphasized that although the provision allows the Ecozone or Freeport Enterprise to generate income from sources outside the Ecozone or 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.

A basic rule in statutory construction is that every part of a statute must be considered together with other parts, and kept subservient to the general intent of the whole law. The statute's clauses and phrases must not be taken as detached and isolated expressions, but the whole and every part thereof must be considered in fixing the meaning of any of its parts in order to produce a harmonious whole.[27]

Section 8 of DO No. 3-08 must be read in harmony with Section 5 of the same, which pertains to basis of where the Special 5% Tax must be imposed on, to wit:

> "SECTION 5. *The Special Five Percent (5%) Tax on Gross Income Earned (GIE).* –

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[25] Paragraph 6, Joint Stipulation of Facts and Issues, Division Docket (CTA Case No. 9286) – Vol. I, p. 209.

[26] Petition for Review, EB Docket, p. 9 vis-à-vis Comment (Re: Petition for Review Dated September 14, 2018), EB Docket, p. 3.

[27] *Philippine International Trading Corporation vs. Commission on Audit,* G.R. No. 183517, June 22, 2010.

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 **shall apply**:

1. **Gross Income Earned (GIE) shall refer to gross sales or gross revenue derived from business activities within the subject Ecozone or Freeport**, net of sales discounts, sales returns and allowances minus cost of 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 categorically states that the gross income, refers to gross sales or gross revenue derived from business activities within the subject Ecozone or Freeport. A close reading of paragraph (a) of Section 5 of DO No. 03-08 uses the word "*shall apply*" for purposes of implementing the special 5% tax. As a rule, the use of the word "shall" underscores the mandatory character of the Rule. The term "shall" is a word of command, and one which has always or which must be given a compulsory meaning, and it is generally imperative or mandatory.[28]

Considering that respondent incurred sales of services which were derived in the Customs Territory, these sales are not included in the computation of the special 5% tax on GIE, in lieu of national and local taxes, thus, petitioner is correct in imposing VAT under the NIRC of 1997, as amended.

Respondent's sales of services rendered in the customs territory are subject to VAT and are considered importation by the buyer

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[28] *Cipriano Enriquez et al., vs. Maximo Enriquez (now deceased) et. al.,* G.R. No. 139303, August 25, 2005.

Petitioner argues that the sales of services rendered by respondent outside the Ecozone are technically considered as importations by the buyers from the Custom Territory and are subject to VAT under the Tax Code of 1997.

On the other hand, respondent counter-argues that the principle of technical importation does not apply to respondent's sales of services within the Customs Territory. The principle of technical importation applies only to the sale of goods and properties by the Freeport Zone-registered enterprises to a buyer from the Customs Territory based on 08/A8 of RMC No. 50-2007. Even assuming for the sake of argument that respondent's sales of services to enterprises within the Customs Territory are considered "technical importations", respondent respectfully submits that 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.

We agree with petitioner.

One of the important principles of the Philippine VAT system is the Destination Principle. According to the Destination Principle, goods and services are taxed only in the country where these are consumed.[29]

Relative thereto, consumption is the "the use of a thing in a way that thereby exhausts it." Applied to services, the term means the performance or "successful completion of a contractual duty, usually resulting in the performer's release from any past or future liability xxx.[30]

In connection with the said principle, it is well-settled that export processing zones are to be managed as a separate customs territory from the rest of the Philippines, and thus, for tax purposes, are effectively considered as foreign territory.[31] As a result, sales made by a supplier in the Customs Territory to a purchaser in the Ecozone shall be treated as an exportation from the Customs Territory. Conversely, sales made by a supplier from the Ecozone to a

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[29] *Atlas Consolidated Mining Development Corporation vs. Commissioner of Internal Revenue*, G.R. Nos. 141104 & 148763, June 8, 2007.
[30] *Commissioner of Internal Revenue vs. American Express International, Inc.*, G.R. No. 152609, June 29, 2005.
[31] *Id.*

purchaser in the Customs Territory shall be considered as an importation into the Customs Territory.[32]

In the present case, respondent's place of business is located in Bicentennial Hills, Clark Freeport Zone (CFZ), Philippines.[33] Its site is specifically located inside CFZ.

The case of *Secretary of Finance Cesar B. Purisima vs. Representative Carmelo F. Lazatin*[34] is instructive as to the nature and tax situs of an enterprise inside the CFZ, hereby quoted below:

> "In 1992, Congress enacted RA 7227 otherwise known as the "Bases Conversion and Development Act of 1992" to enhance the benefits to be derived from the Subic and Clark military reservations. RA 7227 established the Subic Special Economic Zone and granted such special territory various tax and duty incentives.
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> To effectively extend the same benefits enjoyed in Subic to the Clark FEZ, the legislature enacted RA 9400 to amend RA 7227. Subsequently, the Department of Finance issued Department Order No. 3-2008 to implement RA 9400 (*Implementing Rules).*
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> Under RA 9400 and its Implementing Rules, **Clark FEZ is considered a customs territory separate and distinct from the Philippines customs territory**. Thus, as opposed to importations into and establishments in the Philippines customs territory, which are fully subject to Philippine customs and tax laws, importations into and establishments located within the Clark FEZ (FEZ Enterprises) enjoy special incentives, including tax and duty-free importation. More specifically, Clark FEZ enterprises shall be entitled to the freeport status of the zone and a 5% preferential income tax rate on its gross income, in lieu of national and local taxes.
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> RA 9400 and its Implementing Rules grant the following:

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[32] *Commissioner of Internal Revenue vs. Toshiba Information Equipment (Phils.) Inc.*, G.R. No. 150154, August 9, 2005.
[33] Exhibit "P-2", Division Docket (CTA Case No. 9286) – Vol. 1, p. 372.
[34] G.R. No. 210588, November 29, 2016.

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First, the law provides that importations of raw materials and capital into the FEZs shall be tax- and duty-free. It is the specific transaction (i.e., importation) that is exempt from taxes and duties.

Second, the law also grants FEZ enterprises tax- and duty-free importation and a preferential rate in the payment of income tax, in lieu of all national and local taxes. These incentives exempt the establishment itself from taxation.

Thus, the legislature intended FEZs to enjoy tax incentives in general- whether with respect to the transactions that take place within its special jurisdiction, or the persons/establishments within the jurisdiction. From this perspective, the tax incentives enjoyed by FEZ enterprises must be understood to necessarily include the tax exemption of importations selected into the FEZ.

We have ruled in the past that FEZ enterprises' tax exemptions must be interpreted within the context and in a manner that promotes the legislative intent of RA 7227 and, by extension, RA 9400. Thus, we recognized that FEZ enterprises are exempt from both direct and indirect internal revenue taxes. In particular, they are considered VAT-exempt entities.

In line with this comprehensive interpretation, we rule that that tax exemption enjoyed by FEZ enterprises covers internal revenue taxes imposed on goods brought into the FEZ, including the Clark FEZ, such as VAT and excise tax." *(Emphases and Underscoring Supplied)*

Based on the foregoing, the legislature's intent in RA 7227, as amended by RA 9400 is that FEZ enterprises enjoys the tax incentives granted thereof specifically to **transactions that take place within the jurisdiction** or to persons/establishments within the jurisdiction. As such, respondent's sales of services that were destined for consumption within the customs territory or outside its place of jurisdiction should be considered as importations by the buyer and exportation on the part of respondent that is subject to 12% VAT.

Respondent failed to overcome by sufficient evidence the presumption of correctness of the deficiency tax assessment

Respondent argues that the presumption of correctness of assessment does not apply as it was able to sufficiently prove that the assessment was issued without legal and factual basis.

Again, We do not agree.

In the instant case, respondent admitted that it generated sales of services within the customs territory in the amount of ₱19,827,708.97. It is undisputed that respondent did not present any documentary evidence in support of its VAT transactions. Neither did it file any VAT return to overthrow petitioner's assessment. What is only clear from the records is that VAT was assessed on respondent's sale of services to customers outside the Clark Freeport Zone area.

It must be emphasized that in the determination of the tax liability of respondent, the Court is guided by the rule that tax assessments 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 the BIR examiner and approved by his superior officers will not be disturbed.[35]

Considering that respondent failed to overcome by sufficient evidence present that it is not liable to pay the assessed deficiency VAT, the presumption of correctness of the subject assessment remains.

Respondent is not liable for payment of Compromise Penalty

In the FAN and FLD, the item on compromise penalty must be deleted. A compromise penalty is a certain amount of money which

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[35] *Commissioner of Internal Revenue vs. Bank of the Philippine Islands,* G.R No. 134062, April 17, 2007, citing Sy Po vs. Court of Tax Appeals, G.R. No. L-81446, August 18, 1988.

the taxpayer pays to compromise a tax violation. This is usually paid in lieu of a criminal prosecution.[36]

The nature of a compromise penalty is explained in the case of *Commissioner of Internal Revenue vs. Armando L. Abad*[37], to wit:

> "**a compromise implies agreement. One party cannot impose it upon the other**. If an offer of compromise is rejected by the taxpayer, as in this case, the Commissioner of Internal Revenue should file a criminal action if he believes that the taxpayer is criminally liable for violation of the tax law as the only way to enforce a penalty. As penalty can be imposed only on a finding of criminal liability." *(Emphasis supplied)*

Based on the foregoing, the nature of a compromise penalty implies a mutual agreement between the parties and it cannot be imposed without the consent of the other.

A closer look at paragraphs 4 and 5 of Part III (Guidelines and Instructions) of RMO No. 19-2007[38] reads as follows:

> "4. Although all amounts of compromise penalties incident to violations shall be itemized in the assessment notice and/or demand letter, **the same should not form part of assessment notice that reflects deficiency basic tax, surcharge and interest but should appear in a separate assessment notice/demand letter as the amount suggested to the taxpayer to pay in lieu of criminal prosecution**. If paid, the compromise penalties shall be collected and accounted for under the usual procedures, as internal revenue collection.
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> 5. **Since compromise penalties are only amounts suggested in settlement of criminal liability, and may not therefore be imposed or exacted on the taxpayer**, the violation shall be referred to the appropriate office for criminal action in the event that a taxpayer refuses to pay

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[36] Aban, *Law of Basic Taxation in the Philippines* (2001), p. 237.
[37] G.R. No. L-19627, June 27, 1968.
[38] The Consolidated Revised Schedule of Compromise Penalties for Violations of the National Internal Revenue Code.

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the suggested compromise penalty." *(Emphases and underscoring supplied)*

A plain reading of the regulations says that compromise penalties are amounts suggested in settlement of criminal liability, and may not therefore, be imposed or exacted on the taxpayer.

In the instant case, there is no showing that respondent consented to the compromise penalty. Hence, its imposition should be deleted.

In view of the foregoing, petitioner's assessment against respondent covering deficiency VAT for CY 2011 is modified in the reduced amount of ₱2,974,156.35, broken down 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**

Imposition of deficiency and delinquency interests under the TRAIN Law.

Republic Act (RA) No. 10963, otherwise known as the *"Tax Reform for Acceleration and Inclusion"* (TRAIN Law), took effect on January 1, 2018, amending pertinent provisions of the NIRC of 1997, among which is Section 249.[39] The amended provision

[39] Section 249 of the NIRC of 1997 reads:
"SEC. 249. *Interest.* –
(A) *In General.* – There shall be assessed and collected on any unpaid amount of tax, interest at the rate of twenty percent (20%) *per annum,* or such higher rate as may be prescribed by rules and regulations, from the date prescribed for payment until the amount is fully paid.
(B) *Deficiency Interest.* – Any **deficiency** in the tax due, **as the term is defined in this Code**, shall be subject to the interest prescribed in Subsection (A) hereof, which interest shall be assessed and collected from

of Section 249 now reads as follows:

> "SEC. 249. *Interest.* –
>
> (A) *In General.* – There shall be assessed and collected on any unpaid amount of tax, **interest at the rate of double the legal interest rate for loans or forbearance of any money in the absence of an express stipulation as set by the Bangko Sentral ng Pilipinas from the date prescribed for payment until the amount is fully paid**: *Provided*, **That in no case shall the deficiency and delinquency interest prescribed under Subsections (B) and (C) hereof be imposed simultaneously**.
>
> (B) *Deficiency Interest.* – Any deficiency in the tax due, as the term is defined in this Code, shall be subject to the interest prescribed in Subsection (A) hereof, which interest shall be assessed and collected from the date prescribed for its payment until the full payment thereof, or upon issuance of a notice and demand by the Commissioner of Internal Revenue, whichever comes earlier.
>
> (C) *Delinquency Interest.* xxx." *(Emphasis supplied)*

Based on the foregoing, the following amendments are introduced by the TRAIN Law, to wit:

1. The interest rate is reduced to *"double the legal interest rate for loans or forbearance of any money in the absence of an express stipulation as set by the Bangko Sentral ng Pilipinas."*

   Currently, the legal interest rate is 6%,[40] hence the interest rate to be applied on any unpaid amount of tax shall be 12%, which

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the date prescribed for its payment until the full payment thereof.

(C) *Delinquency Interest.* – In case of failure to pay:

xxx xxx xxx

(3) A deficiency tax, or any surcharge or interest thereon on the due date appearing in the notice and demand of the Commissioner, there shall be assessed and collected on the unpaid amount, interest at the rate prescribed in Subsection (A) hereof until the amount is fully paid, which interest shall form part of the tax." *(Emphases supplied)*

[40] BSP MB Circular No. 799, Series 2013 which took effect on July 1, 2013.

is lower than the twenty (20%) interest imposed under the NIRC of 1997.

2. In no case shall the deficiency interest and delinquency interest be imposed simultaneously. As such, the overlapping of interest penalties under the NIRC of 1997, has been effectively eliminated.

3. The period for the application of deficiency interest is modified in that it shall still begin from the date prescribed for its payment, but now, it shall end either: until the full payment thereof, **or upon issuance of a notice and demand by the CIR, whichever comes earlier**. Hence, under the TRAIN law, the running of the period for the computation of the deficiency interest may be interrupted by the issuance **of a notice and demand by the CIR.**

   It bears noting that under the NIRC of 1997, the deficiency interest shall be assessed and collected from the date prescribed for its payment until the full payment thereof and is not interrupted by the issuance of a notice or demand from the CIR.

The principle is well entrenched that statutes, including administrative rules and regulations, operate prospectively only, unless the legislative intent to the contrary is manifest by express terms or by necessary implication.[41]

As a corollary, there being no clear legislative intent to retroactively apply the TRAIN law, the same should only be applied prospectively, *i.e.*, beginning January 1, 2018.

Considering the foregoing principles, the effects of the amendments under the TRAIN Law, particularly the imposition of interests, shall be applied to this case.

Thus, beginning January 1, 2018, the interests to be imposed must already be 12%, and there must no longer be a simultaneous imposition of deficiency and delinquency interests.

WHEREFORE, in light of the foregoing considerations, the instant *Petition for Review* is **GRANTED.** The Decision dated May 3,

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[41] *BPI Leasing Corporation vs. Court of Appeals, et al.*, G.R. No. 127624, November 18, 2003.

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[42])	
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**

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

[42] Division Docket (CTA Case No. 9286) – Vol. 1, P. 412. *nb*

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.

ERLINDA P. UY
Associate Justice

WE CONCUR:

(With due respect, I adopt the position taken by the Court in Division)
ROMAN G. DEL ROSARIO
Presiding Justice

(With due respect, I vote to affirm the appealed Decision and Resolution)
JUANITO C. CASTAÑEDA, JR.
Associate Justice

(I concur with Presiding Justice Del Rosario and Justice Castañeda)
ESPERANZA R. FABON-VICTORINO
Associate Justice

CIELITO N. MINDARO-GRULLA
Associate Justice

(With Concurring Opinion)
MA. BELEN M. RINGPIS-LIBAN
Associate Justice

(With due respect, I concur with Presiding Justice Del Rosario and Justice Castañeda)
CATHERINE T. MANAHAN
Associate Justice

(With Concurring Opinion)
JEAN MARIE A. BACORRO-VILLENA
Associate Justice

MARIA ROWENA MODESTO-SAN PEDRO
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.

ROMAN G. DEL ROSARIO
Presiding Justice

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE, Petitioner,	**CTA EB NO. 1920** (CTA Case No. 9286)
- versus -	Present: **DEL ROSARIO,** *P.J.,* **CASTAÑEDA, JR., UY, FABON-VICTORINO, MINDARO-GRULLA, RINGPIS-LIBAN, MANAHAN, BACORRO-VILLENA,** *and* **MODESTO-SAN PEDRO,** *JJ.*
CLARK WATER CORPORATION, Respondent.	Promulgated: MAR 12 2020 4:09 p.m.

x- x

CONCURRING OPINION

RINGPIS-LIBAN, *J.:*

I concur in the *ponencia* in granting the "Petition for Review" filed by the Commissioner of Internal Revenue.

I am of the firm belief that sale of goods and services made by a Philippine Economic Zone Authority ("PEZA") registered enterprise to an entity in the customs territory, used or rendered outside the ecozone, is deemed an importation, and is subject to twelve percent (12%) VAT.

The Philippines adheres to the cross-border doctrine and destination principle for VAT.[1] Under the cross-border doctrine, no VAT shall be imposed to form part of the cost of goods destined for consumption outside of the

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[1] Coral Bay Nickel Corporation v. Commissioner of Internal Revenue, G.R. No. 190506, June 13, 2016 *citing* Section 2 of Revenue Memorandum Circular No. 74-99.

territorial border of the taxing authority. Whereas under the destination principle, goods and services are taxed only in the country where these are consumed.[2]

Corollary, actual export of goods and services from the Philippines to a foreign country is free of VAT. While, those destined for use or consumption within the Philippines shall be imposed with VAT.[3] In other words, in our jurisdiction, exports are zero-rated but imports are taxed.

In relation to entities which are registered with PEZA, the significance of these two tenets on VAT imposition are profound.

Section 8[4] of Republic Act ("R.A.") No. 7916[5] mandates that PEZA shall manage and operate export processing zones (*i.e.*, ecozones) as a separate customs territory from the rest of the Philippines. Thus, for tax purposes, the ecozones are effectively considered as foreign territory separate and distinct from the customs territory.

Because of the fiction that an ecozone is considered a foreign territory, the VAT treatment of sales of goods and services to and by PEZA registered enterprises within and without the ecozone was outlined in Revenue Memorandum Circular ("RMC") No. 74-99[6] as follows:

1) Sales inside the ecozone from one PEZA registered enterprise to another PEZA registered enterprise – exempt from VAT [but if PEZA registered enterprise is not subject to the five percent (5%) special tax regime under Section 24[7] of R.A. No. 7916, subject to VAT at zero percent (0%)];

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2 *See* Commissioner of Internal Revenue v. Seagate Technology (Philippines), G.R. No. 153866, February 11, 2005.

3 *See* Commissioner of Internal Revenue v. Toshiba Information Equipment (Phils.), Inc., G.R. No. 150154, August 09, 2005.

4 **SEC. 8.** ECOZONE to be Operated and Managed as Separate Customs Territory. – The ECOZONE shall be managed and operated by the PEZA as separate customs territory.

The PEZA is hereby vested with the authority to issue certificate of origin for products manufactured or processed in each ECOZONE in accordance with the prevailing rules or origin, and the pertinent regulations of the Department of Trade and Industry and/or the Department of Finance.

5 The Special Economic Zone Act of 1995.

6 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, October 15, 1999.

7 **SEC. 24.** Exemption from National and Local Taxes.- Except for real property taxes on land owned by developers, no taxes, local and national, shall be imposed on business establishments operating within the ECOZONE. In lieu thereof, five percent (5%) of the gross income earned by all business enterprises within the ECOZONE shall be paid and remitted as follows:

a. Three percent (3%) to the National Government;

b. Two percent (2%) which shall be directly remitted by the business establishments to the treasurer's office of the municipality or city where the enterprise is located.

2) Sales made by a supplier in the customs territory to a purchaser in the ecozone (*i.e.*, PEZA registered enterprise) shall be treated as an exportation from the customs territory - subject to VAT at zero percent (0%); and

3) **Sales made by a supplier from the ecozone (*i.e.*, PEZA registered enterprise) to a purchaser in the customs territory shall be considered as an importation into the customs territory - subject to VAT at twelve percent (12%).**

From the summary above, it is clear that twelve percent (12%) VAT is imposed on sales of goods and services by a PEZA registered enterprise seller to a buyer from customs territory (*i.e.*, local/domestic sales), as in the instant case.

Prior to RMC No. 74-99 however, whether a PEZA registered enterprise was exempt or subject to VAT depended on the type of fiscal incentives availed of by the said enterprise. If the PEZA registered enterprise avails of the five (5%) special tax regime, it is exempt from all taxes including VAT, but if it avails of the income tax holiday (ITH) under Executive Order No. 226[8], it shall be exempt from income taxes for a number of years but not VAT.[9]

As discussed by the Supreme Court in *Commissioner of Internal Revenue v. Toshiba Information Equipment (Phils.), Inc.*[10], said rule which totally relied on the choice of fiscal incentives of the PEZA registered enterprise was already revised. As it now stands, the tax treatment of sales of goods and services of PEZA registered enterprises is based on the principles of "separate customs territory" and "cross border doctrine", *viz*:

> "According to the old rule, Section 23 of Rep. Act No. 7916, as amended, gives the PEZA-registered enterprise the option to choose between two sets of fiscal incentives: (a) The five percent (5%) preferential tax rate on its gross income under Rep. Act No. 7916, as amended; and (b) the income tax holiday provided under Executive Order No. 226, otherwise known as the Omnibus Investment Code of 1987, as amended.
>
> The five percent (5%) preferential tax rate on gross income under Rep. Act No. 7916, as amended, is in lieu of all taxes. Except for real property taxes, no other national or local tax may be

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8 The Omnibus Investments Code Of 1987, July 16, 1987.

9 Commissioner of Internal Revenue v. Cebu Toyo Corporation, G.R. No. 149073, February 16, 2005; Commissioner of Internal Revenue v. Sekisui Jushi Philippines, Inc., G.R. No. 149671, July 21, 2006.

10 G.R. No. 150154, August 09, 2005.

imposed on a PEZA-registered enterprise availing of this particular fiscal incentive, not even an indirect tax like VAT.

Alternatively, Book VI of Exec. Order No. 226, as amended, grants income tax holiday to registered pioneer and non-pioneer enterprises for six-year and four-year periods, respectively. Those availing of this incentive are exempt only from income tax, but shall be subject to all other taxes, including the ten percent (10%) VAT.

This old rule clearly did not take into consideration the Cross Border Doctrine essential to the VAT system or the fiction of the ECOZONE as a foreign territory. It relied totally on the choice of fiscal incentives of the PEZA-registered enterprise. <u>Again, for emphasis, the old VAT rule for PEZA-registered enterprises was based on their choice of fiscal incentives: (1) If the PEZA-registered enterprise chose the five percent (5%) preferential tax on its gross income, in lieu of all taxes, as provided by Rep. Act No. 7916, as amended, then it would be VAT-exempt; (2) If the PEZA-registered enterprise availed of the income tax holiday under Exec. Order No. 226, as amended, it shall be subject to VAT at ten percent (10%).</u> **Such distinction was abolished by RMC No. 74-99**, which categorically declared that all sales of goods, properties, and services made by a VAT-registered supplier from the Customs Territory to an ECOZONE enterprise shall be subject to VAT, at zero percent (0%) rate, regardless of the latter's type or class of PEZA registration; and, thus, affirming the nature of a PEZA-registered or an ECOZONE enterprise as a VAT-exempt entity."[11]

All told, I vote to **GRANT** the Petition for Review filed by the Commissioner of Internal Revenue.

Ma. Belen S L

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

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[11] *Emphasis and underscoring supplied.*

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

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

Present:

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

- versus -

CLARK WATER CORPORATION,
Respondent.

Promulgated:
MAR 12 2020 4:09 p.m.

x - x

CONCURRING OPINION

BACORRO-VILLENA, J.:

I concur with the *ponencia* of our esteemed colleague, Hon. Justice Erlinda P. Uy and I vote to grant the petition. Below, I wish to underscore the basis of my concurrence.

In Section 108 (B) (3) of the Tax Code of 1997, it is provided that:

> ...
>
> **SEC.** 108. *Value-added Tax on Sale of Services and Use or Lease of Properties.* —
>
> ...
>
> (B) *Transactions Subject to Zero Percent (0%) Rate.* — The following services performed in the Philippines by VAT-registered persons shall be subject to zero percent (0%) rate.
>
> ...
>
> (3) **Services rendered to persons or entities whose exemption under special laws or international agreements** to which the Philippines is a signatory effectively subjects the supply of such services to zero percent (0%) rate[.][1]
>
> ...

From the foregoing, a sale of service by a value-added tax (**VAT**)-registered person, such as respondent, is entitled to a zero-rated VAT provided that the service is rendered to persons or entities enjoying VAT exemption under special law or an international agreement to which the Philippines is a signatory. Considering that herein respondent's sale of service was made to persons or entities in the Customs Territory ***not*** enjoying VAT exemption, such should be subject to 12% VAT.

Moreover, Section 15 of Republic Act (**RA**) No. 7227[2], as amended by RA No. 9400[3], states:

> ...
>
> SEC. 15. *Clark Special Economic Zone (CSEZ) and Clark Freeport Zone (CFZ).* —
>
> ...
>
> **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 of the CFZ, as well as provide incentives such as tax and duty-free importation of raw materials and capital equipment.** However, exportation or 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,

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1 Emphasis supplied.

2 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.

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

> the National Internal Revenue Code of 1997, as amended, and other relevant tax laws of the Philippines.
>
> ...
>
> Duly registered business enterprises that will operate in the Special Economic Zones 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.**"[4]
>
> ...

As can be gleaned from the above-quoted provision, CSEZ and CFZ - registered enterprises are entitled to the same tax and duty incentives as provided for Philippine Economic Zone Authority (**PEZA**) - registered enterprises.

Revenue Memorandum Circular (**RMC**) No. 74-99[5] outlines the tax incentives of PEZA - registered enterprises as regards their sales within and without the ecozone as follows:

> ...
>
> 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). -
>
> ...
>
> 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 R.A. No. 7916, as implemented by the PEZA rules and regulations hence, such seller 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**

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4 Emphasis supplied.

5 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.

> **method of general apportionment provided in the immediately preceding paragraph.**
>
> 3) Sale of Goods, by a PEZA Registered Enterprise, to Another PEZA Registered Enterprise (i.e., Intra ECOZONE Sales of Goods). —
>
> ...
>
> 4) Sale of Service by ECOZONE Enterprise, to Another ECOZONE Enterprise (Intra ECOZONE Enterprise Sale of Service):
>
> a. If PEZA-Registered Seller is Subject to the 5% Special Tax Regime. — Exempt from VAT or any percentage tax, pursuant to Sec. 24, R.A. 7916.
> b. If PEZA-Registered Seller is Subject to Taxes Under the NIRC . — Subject to zero percent (0%) VAT...[6]
>
> ...

The above-cited categorically and clearly provides that sale of services by PEZA - registered enterprises to a buyer from Customs Territory, as in the instant case, is not covered by 5% special tax regime, hence, subject to 12% VAT.

Additionally, the quoted provisions of RMC No. 74-99 are consistent with the well-settled Cross Border Doctrine of our VAT system which means that 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.[7] Conversely, those destined for use or consumption within the Philippines (Customs Territory) shall be imposed with the 12% VAT.

To clarify, RMC No. 50-2007[8] was also issued dealing with tax treatment of sale or exchange of goods and services. Section 3 thereof reads:

> ...
> SECTION 3. Clarificatory Questions and Answers. —

6 Emphasis supplied.

7 *Commissioner of Internal Revenue v. Seagate Technology (Philippines)*, G.R. No. 153866, 11 February 2005.

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.

> ...
>
> 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.**[9]
>
> ...

The first part pertains to the **income tax treatment** of the sales within the Customs Territory. Should the income from within the Customs Territory exceeds the 30% total income from all sources, then it <u>shall</u> be subject to the income tax laws of the Customs Territory. On the other hand, the second part addresses the **VAT treatment** which provides 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**. This interpretation is congruent with the outline provided under RMC No. 74-99.

With the foregoing, I vote to **GRANT** the Petition for Review and uphold the deficiency VAT assessment on respondent's sale of services within the Customs Territory.

JEAN MARIE A. BACORRO-VILLENA
Associate Justice

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[9] Emphasis supplied.