REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

-versus-

NIDEC COPAL PHILIPPINES CORPORATION,
Respondent.

C.T.A. EB No. 250
(C.T.A. Case No. 6577)

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NIDEC COPAL PHILIPPINES CORPORATION,
Petitioner,

-versus-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. EB No. 255
(C.T.A. Case No. 6577)

Present:

Acosta, P.J.,
Castañeda, Jr.,
Bautista,
Uy,
Casanova,
Palanca-Enriquez, JJ.:

Promulgated:
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DECISION

BAUTISTA, J.:

The Case

Before the Court *En Banc* are two Petitions for Review filed pursuant to Section 18 of Republic Act ("RA") 1125, as amended by Section 11 of RA

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9282. The first petition docketed as C.T.A. EB No. 250 filed by the Commissioner of Internal Revenue seeks the partial reversal of the Decision dated September 25, 2006 and the Resolution dated January 3, 2007 of the Second Division of this Court ("Court in Division") in C.T.A. Case No. 6577 captioned *"Nidec Copal Philippines Corporation vs. Commissioner of Internal Revenue,"* which cancelled deficiency income and documentary stamp tax assessments, including increments on the late payment of expanded withholding tax on interest, in the total amount of ₱2,034,711.17 for the fiscal year ended March 31, 1999, but ordered Nidec Copal Philippines Corporation to pay to the Commissioner of Internal Revenue the amount of ₱8,060,874.94 representing income, final withholding and fringe benefits taxes, inclusive of increments, plus 20% delinquency interest from May 20, 2002 until fully paid.

On the other hand, the second petition docketed as C.T.A. EB No. 255 was filed by Nidec Copal Philippines Corporation praying that this Court render judgment finding it not liable for the amount of ₱8,060,874.94, and for the 20% delinquency interest imposed thereon.

Since both Petitions for Review involve the same parties and subject matter, this Court deemed it necessary to consolidate the petitions.

Antecedent Facts

As summarized by the Court in Division, the facts are:

"In their Joint Stipulation of Facts and Issues, the parties stipulated as follows:

'1. Petitioner is a domestic corporation duly licensed by the Securities and Exchange Commission ("SEC") and registered with the Philippine Economic Zone Authority ("PEZA") with PEZA Registration Certificate No. 91-019 dated July 5, 1991. It has office

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address at main Avenue corner Binary Street, Light Industry & Science Park of the Philippines I, Special Economic Zone, Bo. Diezmo, Cabuyao, Laguna.

Petitioner may be served with papers, orders, and other processes of this Honorable Court through undersigned counsel.

2. Respondent is the Commissioner of Internal Revenue (CIR), duly appointed to perform the duties of his office, including, *inter alia*, the power to decide disputed assessments, subject to the exclusive appellate jurisdiction of this Honorable Court, pursuant to *Section 4* of the *Tax Code*.

3. Respondent holds office and, hence, may be served with all papers, orders, and other legal processes of this Honorable Court at the 5th Floor, Bureau of Internal Revenue ("BIR") National Office Building, BIR Road, Diliman, Quezon City.

4. On April 29, 2002, Petitioner received copies of the Formal Letter of Demand and the Final Assessment Notice (Assessment Notice No. 57-99) both dated April 19, 2002 issued by Respondent. In the said letter of demand and assessment notice, Respondent assessed petitioner for deficiency income, fringe benefits, expanded withholding, and documentary stamp taxes and compromise penalty in the aggregate amount of ₱10,713,749.74, inclusive of increments, for fiscal year ended March 31, 1999, computed as follows:

	Tax Type	Total Tax Due
I.	Income Tax - Unregistered Activity	₱2,168,639.65
II.	Income Tax – Special Tax Rate	657,278.39
III.	Income Tax – Disallowance	613,165.16
IV.	Documentary Stamp Tax - Loan Agreements, Instruments and Paper	1,095,622.77
V.	Final Withholding Tax – Royalty Expense	5,592,789.05
VI.	Increments - Late Payment of EWT on Interest	220,411.00
VII.	Documentary Stamp Tax - Loan and Lease Agreements	61,399.01
VIII.	Fringe Benefits Tax - Rental (Housing)	304,444.71
	Total	**₱10,713,749.74**

5. Pursuant to *Section 228* of the *Tax Code*, Petitioner made a timely protest thereof in a letter dated May 29, 2002 filed with the Revenue Region No. 9 of the Bureau of Internal Revenue ("BIR") on May 29, 2002. Said protest letter specified and discussed the factual and legal bases of the protest against the assessment and requested that the same be cancelled and, consequently, the case against Petitioner be considered closed and terminated. *Section 228* of the *Tax Code* is applicable since the assessments were issued when the 1997 Tax Code is already in effect.

6. The 180-day period within which Respondent is mandated by law to render a decision on the protest filed by a taxpayer lapsed on November 25, 2002, but Respondent failed to act on Petitioner's protest. Hence, petitioner has thirty (30) days from said date, or until

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December 26, 2002 (December 25, 2002 being a holiday), within which to appeal to this Honorable Court.

7. This Honorable Court has exclusive appellate jurisdiction to take cognizance of the instant Petition pursuant to *Section 228* of the *Tax Code* in conjunction with *Section 4* of the same *Code*, as well as *Section 7 of Republic Act No. 1125*, otherwise known as *"An Act Creating the Court of Tax Appeals."* '

In his amended answer, respondent alleged by way of special and affirmative defenses that there were income/adjustments from unregistered activities which were excluded in the computation of taxable income and these consist of rework charges (₱276,329.90), Vishay losses (₱7,803,456.74) and selling price adjustment (₱232,302.00); that a deficiency income tax in the amount of ₱387,342.00 resulted from the disallowance of the inventory written- off and communication expense; *Revenue Regulations No. 16-99* allowing Subic Special Economic and Freeport Zone (SSEFZ) entities to deduct communication expenses, does not state that the same is applicable to PEZA registered entities; SSEFZ and PEZA registered entities are similar only insofar as the 5% preferential tax is concerned; petitioner's Loan Agreements with Copal Co. Ltd. ($7,400,000.00 and JPY250,000,000.00) and Temic Telefunken ($480,000.00) were not subjected to DST of ₱1,095,622.77 pursuant to *Section 180 of the Tax Code*; petitioner did not pay DST of ₱61,196.95, inclusive of increments and surcharge, on its Lease Contract (₱2,390,160.00) and Loan Agreement (₱14,442,278.00) with its affiliate, El Nuevo Diezmo Realty, Inc., pursuant to *Sections 194 and 180 of the Tax Code*; petitioner's royalty expense charge on operations amounted to ₱17,550,137.00 with an additional adjustment of ₱76,069.31; however, the total remittance of final withholding tax on royalty payments amounted only to ₱1,370,500.85 resulting to a discrepancy of ₱3,017,033.00 and ₱19,767.32, excluding increments and surcharges; petitioner failed to remit to the BIR within the prescribed period a final withholding tax on interest in the amount of ₱316,018.00, resulting to the imposition of increments in the amount of ₱220,411.00, pursuant to *Revenue Regulations 2-98*; and the fringe benefit tax assessment was issued within the prescribed period.

Petitioner presented Wilfredo Onag, as witness, and submitted its 'Formal Offer of Evidence', which was admitted by the Court, except for *Exhibits 'W', 'W-1', 'W-2', 'X', and 'X-1'* for failure of the petitioner to present the originals for comparison.

Upon petitioner's 'Motion For Partial Reconsideration', the Court admitted *Exhibits 'W' and 'X'*, inclusive of their submarkings.

On the other hand, respondent Commissioner of Internal Revenue presented Wilma Enrique, as witness, and submitted his Formal Offer of Evidence, which was all admitted by the Court.

Both parties were ordered to file their simultaneous memoranda, within thirty (30) days from notice. Upon their respective motions,

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petitioner was granted thirty (30) days from July 25, 2005 or until August 24, 2005, and respondent was granted a total extension of forty five (45) days from July 27, 2005 or until September 10, 2005, within which to file their respective memoranda.

On August 31, 2005, petitioner filed a 'Motion To Admit', which the Court granted and the 'Memorandum For the Petitioner' was admitted.

On the other hand, respondent filed his 'Memorandum For the Respondent' on September 12, 2005.

Thereafter, the case was deemed submitted for decision."

The Ruling of the Court in Division

In a Decision promulgated on September 25, 2006, the Court in Division ruled as follows:

1. Petitioner's income from scrap sales and from other activities is subject to the 34% income tax[1] under Section 27, in relation to Sections 31 and 32 of the National Internal Revenue Code ("NIRC") of 1997, as amended;
2. Petitioner's rework charges, vishay losses, and selling price adjustment were already included in the computation of petitioner's gross income earned for the fiscal year ending March 31, 1999 and subjected to the 5% final tax on its Gross Income Earned ("GIE") for PEZA-registered enterprises;
3. Petitioner's Inventory written-off and communication expenses are proper disallowances from petitioner's claimed deduction for cost of sales for the fiscal year 1999;
4. Petitioner is not liable for deficiency documentary stamp tax ("DST") on its loan agreements with its Japanese licensor and a non-resident

[1] 34% effective January 1, 1998 and 33% effective January 1, 1999, pursuant to RA 8424.

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German corporation since petitioner's 5% final tax on its GIE as a PEZA-registered enterprise, is in lieu of all local and national taxes;

5. The formal letter of demand and assessment notice issued on April 19, 2002 is beyond the three-year prescriptive period within which respondent could make an assessment for deficiency final withholding tax ("FWT") for the months of April 1998 to February 1999;
6. Petitioner is liable for deficiency FWT on Royalty expense for the month of March 1999 for failure to explain the discrepancy between the FWT remittances and the royalty expenses claimed by petitioner, plus 25% surcharge and interest;
7. The assessment for deficiency increments for late payment of FWT on the accrued interest on petitioner's foreign loan from Copal-Japan is without factual and legal basis as petitioner timely remitted the FWT due within the prescribed period;
8. Petitioner is not liable for deficiency DST on its loan agreement and lease contract with its affiliate, El Nuevo Diezmo Realty, Inc. since petitioner's 5% final tax on GIE is in lieu of all local and national taxes;
9. Except for the fourth quarter, respondent's right to assess deficiency fringe benefits tax ("FBT") for the fiscal year ending March 31, 1999 is already barred by prescription; and
10. Petitioner is liable for deficiency FBT on its rental expense for three residential properties, plus 25% surcharge and interest.

The dispositive portion of the Decision reads as follows:

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"**WHEREFORE**, in view of all the foregoing, the Petition for Review is hereby **PARTIALLY GRANTED**. The following deficiency tax assessments in the total amount of ₱2,034,711.17 are hereby **CANCELLED** and **WITHDRAWN** for lack of merit:

INCOME TAX - SPECIAL TAX RATE	₱ 657,278.39
DOCUMENTARY STAMP TAX - LOAN AGREEMENTS, INSTRUMENT & PAPER	1,095,622.77
INCREMENTS - LATE PAYMENT OF EWT ON INTEREST	220,411.00
DOCUMENTARY STAMP TAX - LOAN & LEASE AGREEMENTS	61,399.01
TOTAL	**₱2,034,711.17**

However, petitioner is hereby **ORDERED TO PAY** to respondent the following deficiency tax assessments for fiscal year 1999 in the total amount of **₱8,060,874.94**, broken down as follows:

TYPE OF TAX	TOTAL TAX DUE (W/ INCREMENTS)
INCOME TAX - UNREGISTERED ACTIVITY	₱1,812,636.48
INCOME TAX - DISALLOWANCE	597,165.16
FINAL WITHHOLDING TAX - ROYALTY EXPENSE	5,577,995.30
FRINGE BENEFITS TAX - HOUSING	73,078.00
TOTAL AMOUNT OF DUE	**₱8,060,874.94**

In addition, petitioner is **ORDERED TO PAY** to respondent 20% delinquency interest on ₱8,060,874.94 computed from May 20, 2002 until fully paid, pursuant to *Section 249(C)(3) of the NIRC of 1997, as amended.*

SO ORDERED."

Nidec Copal Philippines Corporation filed a Motion for Reconsideration of the aforementioned Decision of the Court in Division on October 23, 2006. The Commissioner of Internal Revenue likewise filed his Motion for Partial Reconsideration on October 26, 2006.

In a Resolution dated January 3, 2007, the Court in Division denied both Motions for Reconsideration for lack of merit.

Hence, both petitioner Nidec Copal Philippines Corporation and respondent Commissioner of Internal Revenue filed their Petitions for Review with the Court of Tax Appeals *En Banc* (hereafter "this Court") on January 24,

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2007 and February 7, 2007, respectively. The appeal by the Commissioner of Internal Revenue was docketed as C.T.A. EB No. 250 while Nidec Copal Philippines Corporation's appeal was docketed as C.T.A. EB No. 255. In a Resolution dated April 24, 2007, this Court ordered the consolidation of C.T.A. EB No. 250 with C.T.A. EB No. 255. Considering that both parties are petitioners and respondents at the same time, they shall be referred to by their respective names throughout the rest of this Decision. Thus, the term "Commissioner" shall refer to the Commissioner of Internal Revenue and the name "Nidec" shall refer to Nidec Copal Philippines Corporation.

The Issues

The following are the issues raised by the parties in their respective Petitions for Review:

C.T.A. EB No. 250
Commissioner of Internal Revenue vs.
Nidec Copal Philippines Corporation

"WHETHER OR NOT RESPONDENT IS LIABLE FOR DEFICIENCY DOCUMENTARY STAMP TAX (DST) ON ITS LOAN AGREEMENTS AND LEASE CONTRACTS"

C.T.A. EB No. 255
Nidec Copal Philippines Corporation vs.
Commissioner of Internal Revenue

"1. WHETHER PETITIONER'S SALE OF SCRAP IS SUBJECT TO 34% INCOME TAX INSTEAD OF THE 5% PREFERENTIAL TAX RATE FOR A PEZA ENTERPRISE; AND

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2. WHETHER PETITIONER'S INVENTORY WRITE-OFF AND COMMUNICATION EXPENSES ARE VALID EXPENSES UNDER THE PEZA RULES;

3. WHETHER PETITIONER IS LIABLE FOR DEFICIENCY FWT ON ROYALTY EXPENSE; AND

4. WHETHER PETITIONER IS LIABLE FOR DEFICIENCY FRINGE BENEFITS TAX."

The Ruling of the Court En Banc

Both Petitions for Review are unmeritorious.

This Court shall tackle the issues in the order presented.

First Issue:
DST on loan agreements and lease contracts

The Commissioner argues that Nidec should be held liable for DST on its Loan Agreements with Copal Co. Ltd. in the amounts of $7,400,000.00 and JPY250,000,000.00, with Temic Telefunken, a non-resident German corporation, in the amount of $480,000 and with its affiliate El Nuevo Diezmo Realty, Inc. in the amount of ₱14,442,278.40, pursuant to Section 180 of the 1997 NIRC, which reads in part:

> "SEC. 180. Stamp Tax on All Bonds, Loan Agreements, Promissory Notes, Bills of Exchange, Drafts, Instruments and Securities Issued by the Government or Any of its Instrumentalities, Deposit Substitute Debt Instruments, Certificates of Deposits Bearing Interest and Others Not Payable on Sight or Demand. — On all bonds, **loan agreements**, including those signed abroad, wherein the object of the contract is located or used in the Philippines, ...xxx..., there shall be collected a **documentary stamp tax of Thirty centavos (P0.30)** on each Two hundred pesos (P200), or fractional part thereof, of the face value of any such agreement, xxx." *(Emphasis supplied)*

The Commissioner likewise contends that Nidec should be held liable for DST on its Lease Contract in the amount of ₱2,390,160.00 with its affiliate,

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EL Nuevo Realty, Inc., pursuant to Section 194 of the 1997 NIRC, which states:

> "SEC. 194. Stamp Tax on Leases and Other Hiring Agreements. — On each **lease,** agreement, memorandum, or contract for hire, use or rent of any lands or tenements, or portions thereof, **there shall be collected a documentary stamp tax of Three pesos (P3.00) for the first Two thousand pesos (P2,000),** or fractional part thereof**, and an additional One peso (P1.00) for every One thousand pesos (P1,000) or fractional part thereof**, in excess of the first Two thousand pesos (P2,000) **for each year of the term of said contract or agreement**." *(Emphasis supplied)*

According to the Commissioner, the exemption of a PEZA-registered entity from payment of DST in the BIR Rulings relied upon by Nidec refers to exemption of payment from DST on either original issue of stock certificates to their respective stockholders or sale of a factory building located within the Ecozone and the buyer is a PEZA-registered company. Nowhere in those BIR Rulings was there a mention of exemption of payment from DST on loan agreements and lease contracts. Hence, the Nidec's reliance on those BIR rulings is misplaced.

Nidec, in its Comment, asserts that as a PEZA-registered enterprise, it is exempt from all national and local taxes, including the DST. In lieu thereof, it shall pay a preferential tax of 5% on GIE. The aforesaid BIR Rulings are illustrative and not a limitation on the rule that PEZA-registered entities are exempt from DST in view of the imposition of the 5% preferential tax rate on GIE. Stated otherwise, a PEZA-registered enterprise's exemption from DST is not only limited to stock certificates and deeds of sale of real property but to all types of documents that are normally subject to DST under the NIRC. What is important is the *ratio decidendi* of the cited opinions.

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This Court agrees with Nidec.

It is undisputed that Nidec is a PEZA-registered enterprise.[2] As such, it is exempt from all national and local taxes under RA 7916.[3] In lieu thereof, it shall pay a preferential tax of 5% on GIE pursuant to Section 24 of RA 7916, which provides in part:

> "SEC. 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.xxx."

This exemption from the payment of national internal revenue taxes is reiterated in Section 1, Rule XX, Part VII of the Rules and Regulations to Implement RA 7916 ("PEZA Rules"), which states:

> "Rule XX - Gross Income Taxation
>
> SECTION 1. Special Tax Rate. – Pursuant to Section 24 of the Act, ECOZONE Enterprises, except ECOZONE Service Enterprises, shall in lieu of payment of national and local taxes, be liable to the payment of a five percent (5%) final tax on gross income earned xxx."

The Supreme Court has confirmed the rule under RA 7916 that the 5% preferential tax rate on GIE under RA 7916 is in lieu of all taxes. No other national or local tax may be imposed on a PEZA-registered enterprise availing of this particular fiscal incentive, not even an indirect tax like VAT.[4] When RA 8748 was enacted to amend RA 7916, the same prohibition applied, except for real property taxes that presently are imposed on land owned by

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[2] Par. 1, Joint Stipulation of Facts and Issues, page 106, CTA Records.

[3] An Act Providing for the Legal Framework and Mechanisms for the Creation, Operation, Administration, and Coordination of Special Economic Zones in the Philippines, Creating for this Purpose, the Philippine Economic Zone Authority (PEZA), and for other purposes, otherwise known as The Special Economic Zone Act of 1995.

[4] Commissioner of Internal Revenue v. Toshiba Information Equipment (Phils.), Inc., G.R. No. 150154, August 9, 2005, 466 SCRA 211.

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developers. This similar and repeated prohibition is an explicit ratification of the law's intent in not imposing local or national taxes on business enterprises within the ecozone.[5] Since the law does not exclude the DST from the prohibition, it is deemed included. *Exceptio firmat regulam in casibus non exceptis*. An exception confirms the rule in cases not excepted; that is, a thing not being excepted must be regarded as coming within the purview of the general rule.

In addition, the BIR itself has consistently ruled that a PEZA-registered enterprise subject to the preferential tax of 5% on its GIE is exempt from the payment of all other national taxes including the DST.[6]

In the same vein, the BIR has also ruled that a PEZA-registered enterprise subject to the 5% tax is exempt from the payment of DST on the sale and/or lease of its PEZA-registered lots to PEZA-registered and non-PEZA locators.[7]

It is settled that the interpretation of an administrative government agency like the BIR, which is tasked to implement a statute, is generally accorded great respect and ordinarily controls the construction of the courts, unless such construction is clearly shown to be in sharp conflict with the governing statute or the Constitution and other laws.[8] No such conflict is present in this case.

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[5] Commissioner of Internal Revenue v. Seagate Technology (Philippines), G.R. No. 153866, February 11, 2005, 451 SCRA 132.
[6] BIR Ruling No. DA-107-01 dated June 1, 2001; BIR Ruling No. DA-570-04 dated November 10, 2004.
[7] BIR Ruling No. DA-067-04 dated February 12, 2004.
[8] Nestle Philippines, Inc. v. Court of Appeals and Securities and Exchange Commission, G.R. No. 86738, November 13, 1991, 203 SCRA 504.

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It is clear therefore that the DST, which is a national tax, cannot likewise be imposed on a PEZA-registered enterprise availing of the 5% preferential tax rate. Thus, the Court in Division correctly ruled that Nidec's exemption from the payment of local and national taxes includes the DST on its loan agreements and lease contracts imposed under the afore-quoted Sections 194 and 180 of the 1997 NIRC. This is consistent with the pronouncement of the Supreme Court that the incentives offered to PEZA-registered enterprises such as tax exemptions, "ultimately redound to the benefit of the national economy, enticing as they do more enterprises to invest and do business within the zones, thus creating more employment opportunities and infusing more dynamism to the vibrant interplay of market forces."[9]

Second Issue:
Tax Rate on Sale of Scrap Materials

Nidec contends that under PEZA Memorandum Circular No. 2005-032,[10] its sale of scrap materials, which arose from the manufacture of its registered products, is subject to the 5% preferential tax rate and not to the normal corporate income tax.

The Commissioner, on the other hand, posits that since Nidec's sale of scrap materials is not one of its registered activities, it is subject to the

[9] Intel Technology Philippines, Inc. v. Commissioner of Internal Revenue, G.R. No. 166732, April 27, 2007 *citing Commissioner of Customs v. Philippine Phosphate Fertilizer Corporation, G.R. No. 144440, September 1, 2004, 437 SCRA 452, 457.*

[10] Clarification of the Tax Treatment of (a) Gains on Foreign Exchange Transactions; and (b) Sales of Production "Rejects" and "Seconds", Scrap, Raw Materials, Packaging Materials and Other Production Supplies, dated September 15, 2005.

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ordinary income tax rate, pursuant to RA 7916 and Section 1 of Revenue Regulations ("RR") 20-2002.[11]

This Court quotes with approval the ruling of the Court in Division on this issue as follows:

> "*'Scrap'* is a term used to describe manufactured articles or parts rejected or discarded and useful only as material for reprocessing: especially waste and discarded metal (*Webster's New Collegiate Dictionary, 1977 edition*). In other words, these scrap materials are recoverable wastes, where the proceeds derived from the sale thereof shall be taxed in accordance with the applicable provisions of the *NIRC of 1997 referred to under Section 8, Rule VIII, Part V of the PEZA Rules*, to wit:
>
> 'PART V
> *Tax Treatment of Merchandise in the ECOZONES*
> RULE VIII
>
> *Tax Treatment of Merchandise in the Restricted Areas of the ECOZONES*
>
> **SEC. 8. Rejects, Seconds and Recoverable Wastes.** — Subject to the provisions of Section 3 of this Rule, rejects, seconds and recoverable wastes shall, when taken from the restricted areas of the ECOZONES to the customs territory, or to the non-restricted areas of the ECOZONE, be **taxed in accordance with the applicable provisions of the customs and internal revenue laws and regulations of the Philippines.'**
>
> While it is true that the income accruing from petitioner's sale of scrap materials is incidental to petitioner's registered activity, it is specifically provided under the afore-quoted PEZA Rules that the same shall be taxed under the normal circumstances.
>
> **Clearly, the scrap sales amounting to P4,069,919.36 qualify as gross income subject to normal corporate income tax rate (34% effective January 1, 1998 and 33% effective January 1, 1999) under *Section 27*, in relation to *Sections 31 and 32 of the NIRC of 1997, as amended***, which provide, as follows:
>
> xxx xxx xxx
>
> As regards petitioner's other income in the amount of P24,657.63, the same shall also be taxed at the normal rate pursuant to the provisions of the NIRC of 1997 considering that it does not fall under petitioner's registered activity. As correctly pointed out by the respondent, the

[11] Clarifying the Tax Treatment of Income Earned from Unregistered Activities by Enterprises Registered Under the Bases Conversion and Development Act of 1992 and the Philippine Economic Zone Act of 1995 dated October 14, 2002.

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preferential tax rate of 5% applies only to petitioner's registered activity, as provided for under Part VII, Rule XIII of the PEZA Rules, thus:

'Part VII
Incentives to ECOZONE Enterprises
Application and Entitlement

xxx xxx xxx

SEC. 5. Limitation of Entitlement to Incentives. — Incentives granted by the PEZA shall apply only to registered operations of the ECOZONE Enterprises and only during the period of its registration with PEZA.'" *(Emphasis supplied)*

The Court in Division aptly applied Section 8, Rule VIII of the PEZA Rules as it is the pertinent provision. It specifically applies to rejects, seconds and recoverable wastes taken from restricted ECOZONE areas to customs territory and non-restricted areas, and has not been amended. The PEZA Rules prevail over PEZA Memorandum Circular 2005-32 issued by the Director General of PEZA.

On the retroactivity of administrative rules, the Supreme Court has ruled that "an administrative rule interpretative of a statute and not declarative of certain rights and corresponding obligations, is given retroactive effect as of the date of effectivity of the statute."[12] Here, the Circular provided a different rule in taxing the sale of rejects or scraps. It deleted from the taxation coverage of the NIRC, the sale of rejects or scraps and subjected them to the 5% GIE. In effect, the Circular vests a new right to establishments in the ECOZONE which was not previously granted in the PEZA Rules. Hence, being declarative of a new right, said Circular cannot be given retroactive effect.

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[12] Commissioner of Internal Revenue v. Azucena T. Reyes and vice versa, G.R. Nos. 159694 and 163581, January 27, 2006, 480 SCRA 385, *citing Agpalo, Statutory Construction, (4^{th} ed., 1998) p. 375.*

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Third Issue:
Deductibility of Inventory written-off

Nidec avers that the requirements of prior BIR approval and/or presence of a representative from the BIR are mere administrative requirements which should not abrogate the substantive right of the taxpayer to claim the inventory written-off as a deduction. Otherwise, formalities will defeat the taxpayer's substantive rights.

The Commissioner, in his Comment, argues that the inventory write-off was invalid because it was done without prior approval by or any witness from the BIR. Moreover, Nidec did not present competent documentary evidence to establish that the amount written-off actually pertained to destroyed obsolete inventories.

This Court quotes with approval the ruling of the Court in Division on this issue:

> "The Court finds the disallowance proper.
>
> Inventory write-offs refer to losses resulting from the destruction of inventory which cannot be sold even at reduced prices due to obsolescence or deterioration of the inventory (*BIR Ruling DA-476-03, December 10, 2003*). The fact that inventory write-offs are deductible from gross sales for purposes of computing the 5% tax on gross income earned is not disputed. The respondent's examiner disallowed petitioner's claimed inventories written-off in the amount of P5,530,136.33 for being unsubstantiated, there being no prior BIR approval nor the presence of a representative from the BIR. While a certification from the BIR of the actual destruction of the claimed obsolete inventories is not necessary in order that the cost thereof may be written-off and claimed as deduction, **petitioner should have presented competent documentary evidence to establish that the amount of P5,530,136.33 actually pertained to destroyed obsolete inventories. For failure of the petitioner to substantiate the inventory written-off amounting to P5,530,136.33**, this Court sustains the disallowance of the same."[13] *(Emphasis supplied)*

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[13] Pages 20 to 21, Assailed Decision.

It is incumbent upon the taxpayer to prove and substantiate his claim for deduction for obsolete inventories in its income tax return. Nidec having failed to justify and substantiate the deductibility of this expense, the same was properly disallowed.

Fourth Issue:
Deductibility of Communication expenses

Nidec asserts that the same are properly deductible from gross income for purposes of computing the 5% preferential tax. These expenses have been included in the cost of sales because they form part of expenses incurred by Nidec as one of the necessary incidents of its manufacturing process. Also, since enterprises registered with the Subic Special Economic and Freeport Zone ("SSEFZ") are allowed to claim communication expenses as a deduction under RR 16-99, it follows that PEZA-registered enterprises also enjoy the same privilege or benefit and may properly claim their communication expenses as a deduction pursuant to Section 51 of RA 7916.

Nidec further posits that the Court in Division erred in ruling that RR 16-99 is not applicable because RR 2-05 amended RR 16-99 by excluding communication expenses as one of the allowable deductions, since to apply RR 2-05 retroactively will be prejudicial to Nidec.

The Commissioner, on the other hand, submits that communication expenses are not allowed as deduction because it is not among the allowable deductions available to companies availing of the 5% special tax rate under RA 7916. Also, SSEFZ and PEZA-registered entities are similar only insofar as the 5% preferential tax is concerned.

Deductions for income tax purposes partake of the nature of tax exemptions; hence, if tax exemptions are to be strictly construed, then it follows that deductions must also be strictly construed.[14]

PEZA-registered enterprises are similar to SSEFZ-registered enterprises created under RA 7227, which are also subject to the 5% preferential tax rate, in that the privileges, benefits, advantages or exemptions granted to SSEFZ-registered enterprises equally apply to PEZA-registered entities pursuant to Section 51 of RA 7916, which states:

> "51. Ipso-Facto Clause. — **All privileges, privileges, advantages or exemptions granted to special economic zones under Republic Act No. 7227, shall ipso-facto be accorded to special economic zones already created or to be created under this Act.** The free port status shall not be vested upon the new special economic zones." *(Emphasis supplied)*

However, as correctly pointed out by the Court in Division, under Section 57(A) of the Implementing Rules and Regulations of RA 7227, communication expense is not listed as one of the allowable deductions for purposes of computing the 5% tax on GIE by SSEFZ-registered enterprises. Thus:

> "SECTION 57. Obligations and Liabilities.
>
> a. Pursuant to Section 12 (c) of the Act, BSF Enterprises within the SBF shall, in lieu of paying local and national taxes, pay a five (5%) percent final tax on their gross income earned in the following percentages:
>
> xxx xxx xxx
>
> b. "Gross Income Earned" for purposes of these Rules refers to gross sales or gross revenues derived from any business activity, net of returns, discounts and allowances, less costs of sales, cost of production or direct costs of services (depending on the nature of business) but

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[14] Subic Power Corporation v. Commissioner of Internal Revenue, C.T.A. Case No. 6059, May 8, 2003.

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before any deduction for administrative expenses and incidental losses during a given taxable period.

In arriving at the base for which the five (5%) percent final tax stated in the proceeding section shall be applied, the following deductions shall be allowable/unallowable:

1. For Manufacturing, Trading and Infrastructure Development Enterprises:

Allowable Deductions
— Direct salaries, wages or labor expense
— Production supervision salaries
— Raw materials
— Intermediate goods
— Finished goods
— Supplies and fuels used in production
— Depreciation, lease payments or other expenditures on buildings and equipment
— Financing charges associated with fixed assets
— Rent and utility charges associated with buildings and equipment, warehousing or handling of goods

Unallowable Deductions
— Administrative salaries
— Corporate management salaries
— Marketing and sales salaries
— Interest & financial charges on working capital
— Loss on disposal of assets
— Advertising
— Insurance
— Miscellaneous supplies and expenses
— Entertainment expense

xxx xxx xxx"

Neither is it included in Section 2, Rule XX, Part VII of the PEZA Rules, which provides:

"SECTION 2. Gross Income Earned; Allowable Deductions. — For purposes of these Rules, Gross Income earned shall be as defined in Section 2(nn), Rule I of these Rules subject to the following allowable deductions for specific types of enterprises:

1. ECOZONE Export Enterprises, Free Trade Enterprises and Domestic Market Enterprises

- Direct salaries, wages or labor expenses
- Production supervision salaries
- Raw materials used in the manufacture of products
- Goods in process (intermediate goods)
- Finished goods
- Supplies and fuels used in production

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- Depreciation of machinery and equipment used in production, and buildings owned or constructed by an ECOZONE Enterprise
- Rent and utility charges associated with building, equipment and warehouses, or handling of goods
- Financing charges associated with fixed assets

xxx xxx xxx"

While RR 16-99[15] included communication expense as one of the allowable deductions, it was issued only on September 27, 1999, which is after the taxable year covered by the subject assessment – fiscal year ending March 31, 1999. As previously discussed, an administrative rule interpretative of a statute, and not declarative of certain rights and corresponding obligations, is given retroactive effect as of the date of the effectivity of the statute. However, RR 16-99 is declarative of a right or it creates a new right *i.e. the right to deduct a particular type of expense* and not merely interpretative of a law. Consequently, it cannot be applied retroactively.

This Court notes that RR 02-05[16] subsequently repealed the provisions of RR 16-99 and excluded communication expense as one of the allowable deductions.

Fifth Issue:
FWT on Royalty Expense

Nidec points out that the computation by the Court in Division for deficiency FWT is erroneous. It also submits that the Court in Division had no

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[15] Amending Revenue Regulations No. 1-95, as amended, and other related rules and regulations to implement the provisions of paragraphs [b] & [c] of Section 12 of RA 7227, otherwise known as the "Bases Conversion and Development Act of 1992" relative to the tax incentives granted to enterprises registered in the Subic Special Economic and Freeport Zone, dated September 27, 1999.

[16] Consolidated Revenue Regulations Implementing Relevant Provisions of Republic Act No. 7227 otherwise known as "Bases Conversion and Development Act of 1992", Republic Act 7916 as amended otherwise known as "Special Economic Zone Act of 1995", Republic Act No. 7903 otherwise known as "Zamboanga City Special Economic Zone Act of 1995" and Republic Act No. 7922 otherwise known as "Cagayan Special Economic Zone Act of 1995" Thereby Amending Revenue Regulations No. 1-95 as amended by Revenue Regulations No. 16-99, dated February 8, 2005.

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legal and factual basis to assume that the alleged discrepancy of ₱3,921,684.41 pertains to royalty payments for the month of March 1999.

The Commissioner maintains that Nidec failed to show convincing proof to contradict the findings of the BIR examiners.

The Court in Division correctly ruled as follows:

> "Having resolved that only the assessment for deficiency final withholding tax on royalty expense for the month of March 1999 was issued within the period allowed by law, We now proceed to the issue of whether or not petitioner is liable for any deficiency final withholding tax for said month.
>
> A comparison of the royalty payments of P13,707,521.90 upon which the final withholding tax remittances in the amount of P1,370,788.19 was based and the royalty expenses claimed by petitioner for the fiscal year 1997 in the amounts of P17,550,137.00 and P79,069.31 totalling P17,629,206.31 reveals a discrepancy of P3,921,684.41. **Since petitioner did not present any document to prove that the difference of P3,921,684.41 represents royalty payments for any of the months of April 1998 to February 1999, the same shall be considered as payment for the month of March 1999**. Petitioner is therefore liable for the corresponding deficiency final withholding tax in the amount of P5,577,995.30, computed as follows:

Total Royalty Expense for the year	17,629,206.31
Multiplied by FWT Rate	25%
Final Withholding Tax Due for the year	P4,407,301.58
Less: Payments made	1,370,501.00
Deficiency Basic Final Withholding Tax	P3,036,800.58
Add: Surcharge (25%)	759,200.14
Interest (58.68%) (4/26/99-3/31/02)	1,781,994.58
Total Amount Due	P5,577,995.30"

(Emphasis supplied)

Well-settled is the rule that assessments are prima facie presumed correct and made in good faith. It is the taxpayer and not the BIR who has the duty of proving otherwise. In the absence of proof of any irregularity in the performance of official duties, an assessment will not be disturbed. All

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presumptions are in favor of tax assessments. Failure to present proof of error in the assessment will justify judicial affirmance of said assessment.[17]

Records reveal that Nidec failed to present documentary evidence that would show its monthly royalty expense for 1999. It also failed to identify the actual amount of its deficiency final withholding tax which has or has not prescribed. Without the required supporting documents and proper identification of each of the portion which has prescribed, the findings of the BIR was correctly upheld by the Court in Division.

Sixth Issue: Fringe Benefits Tax

Nidec contends that the three (3) real properties located in 28B Garcia Village St., 240 Calatagan St., Ayala Alabang Village and 69 A San Gregorio St., Magallanes Village, respectively, are used as dormitories for its transient employees and charges a monthly rental from the employees who stay therein. Hence, the rental payments for the lease of said properties cannot be considered as fringe benefits subject to FBT.

The Commissioner agrees with the ruling made by the Court in Division as follows:

> "As shown in the examiner's computations, petitioner rented the following residential properties for the fiscal year 1999 for a total amount of ₱2,241,914.10:

28 B. Garcia Village St.	₱ 798,741.65
240 Calatagan St., Ayala-Alabang Village	730,075.45
69A San Gregorio St., Magallanes Village	713,097.00
Total Rental Expense	₱2,241,914.10

[17] Commissioner of Internal Revenue v. Court of Appeals, 242 SCRA 313-314.

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The fact that the rental payments for the residential properties located at 28 B. Garcia Village St. and 240 Calatagan St., Ayala-Alabang Village qualify as fringe benefits subject to FBT under *Section 33 of the NIRC of 1997 is uncontroverted.* What is being objected to by petitioner is that the rental payments for the residential property located at 69A San Gregorio St., Magallanes Village, cannot be considered as fringe benefits subject to FBT under *Section 2.33(B) of RR No. 3-98* because the transient employees who stayed therein were subsequently charged the corresponding dormitory fees, as shown by the sample journal voucher and statement of account for the month of June 1998, marked as *Exhibits W", "W-1", "X" and "X-1".*

Petitioner's contention cannot be sustained.

The sample journal voucher and statement of account referred to by petitioner do not at all prove that the rental payments were subsequently charged to and paid by petitioner's employees. Petitioner should have presented competent documentary evidence to prove actual receipt of rental payments from the employees. For failure to refute the examiner's findings, petitioner is liable to pay deficiency FBT for the fourth quarter of fiscal year ending March 31, 1999 in the amount of ₱73,078.00, computed as follows:

28 B. Garcia Village St.	₱ 204,750.00
240 Calatagan St., Ayala Alabang Village	189,000.00
69A San Gregorio St., Magallanes Village	178,274.25
Total Rental - fourth quarter of FY 1999	₱ 572,024.25
Less: 50% Privilege	286,012.13
Rental Expense subject FBT	₱ 286,012.13
Divided by FBT divisor	67%
Gross-up Monetary Value	₱ 426,883.77
FBT Rate	33%
FBT Due	₱140,871.64
Less: Payment	101,131.58
FBT Balance	₱ 39,740.06
Add: 25% Surcharge	9,935.02
Interest (58.89%) (4/26/99-3/31/02)	23,402.92
Total Amount Due	**₱ 73,078.00"**

We concur with foregoing ruling of the Court in Division. A perusal of the sample journal voucher and statement of account submitted by Nidec shows that such documents are inconclusive proof that the rental payments were

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subsequently charged to and paid by Nidec's employees. Nidec should have presented competent documentary evidence to prove actual receipt of the alleged rental payments from the employees.

In fine, this Court finds no compelling reason to reverse the assailed Decision promulgated on September 25, 2006 and the Resolution dated January 3, 2007.

WHEREFORE, both Petitions for Review are **DISMISSED**. Accordingly, the assailed Decision and Resolution are hereby **AFFIRMED**.

SO ORDERED.

LOVELL R. BAUTISTA
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

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

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

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CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution, it is hereby certified that the above Decision has been reached in consultation with the members of the Court *En Banc* before the case was assigned to the writer of the opinion of this Court.

ERNESTO D. ACOSTA
Presiding Justice

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