LW

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

LA FRUTERA, INC.,
Petitioner,

- versus -

C.T.A. CASE NOS. 5898 and 5937

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

SEP 17 2001

x -- x

DECISION

Two (2) cases were elevated before this Court by way of Petition for Review seeking for the refund or for the issuance of a tax credit certificate in the aggregate amount of P868,598.99 allegedly representing Petitioner's excess or unutilized creditable VAT inputs, thus:

CTA Case No.	Period Involved	Amount
5898	2nd Quarter of 1997	P564,073.10
5937	3rd Quarter of 1997	304,525.79
TOTAL AMOUNT		P868,598.89

In view of the fact that the aforesaid cases involve the same parties and interrelated facts and issues, the Court, upon motion for leave of Court of herein Petitioner, ordered the consolidation of the two (2) cases (see CTA Resolution, March 27, 2000, CTA docket, p. 52).

Thus, the facts as adduced from the records of the case are as follows:

Petitioner is a domestic corporation organized and existing under the laws of the Republic of the Philippines with principal place of business at Datu Paglas Estate, Barangay Digal, Buluan, Maguindanao, Autonomous Region of Muslim Mindanao (ARMM) (see Parties Joint Stipulation of Facts, Item No. 1, CTA dockets p. 32 and 34).

It is a VAT registered taxpayer as evidenced by the BIR Certificate of Registration (Exh. B), dated April 1, 1997, with RDO Control No. 97-107-002104VAT (Exhs. B-1 and B-3). It is at the same time registered with the Board of Investments (BOI) with Certificate of Registration No. EP-014-97 issued on July 7, 1997 (Exh. A). Petitioner's line of business is categorized as a Banana Exporter with Philippine Standard Industry Classification No. 1141 (Exh. B-2).

As a VAT registered taxpayer, Petitioner regularly files its monthly VAT declarations and quarterly VAT returns.

On July 21, 1997, Petitioner filed its quarterly VAT return for the second calendar quarter of the year 1997 declaring a VAT input tax of P564,073.10 from its domestic purchases of goods and services but with no output tax liability (Exh. C).

On October 23, 1997, Petitioner filed its quarterly VAT return for the third calendar quarter of the year 1997 (Exh. C-6) declaring an input tax of P304,525.79 generated from its domestic purchases of goods and services and the input tax from the previous quarter of P564,073.10 or a total input tax of P868,598.89 as of September 30, 1997. Petitioner had no output tax, thus, pursuant to Revenue Audit Memorandum Order (RAMO) No. 2-93, Petitioner filed on June 29, 1999, with the Tax and Revenue Group of the One-Stop-Shop Inter-Agency Tax Credit and Duty Drawback Center of the Department of Finance, an application for tax credit/refund of its excess creditable VAT input payments for the second quarter ended June 30, 1997 in the amount of P564,073.10. Pursuant to the same RAMO, Petitioner likewise filed on August 19, 1999, with the same agency under the Department of Finance, an application for tax credit/refund of its excess creditable VAT input payment for the third quarter ended September 30, 1997 in the amount of P304,525.79.

Meanwhile, on September 27, 1999, Petitioner filed an amended VAT return for the third quarter of 1997 (Exh. C-4) declaring the total amount of P868,598.89 as the total refundable amount of input VAT from its domestic purchase of goods and the input VAT carried over from the previous quarter. Consequently, Petitioner also amended the quarterly VAT return for the 4th quarter of 1997 (Exh. H) to show that the input tax claimed was no longer carried over. This amended VAT return was filed on February 23, 2000.

Up to this date, herein Respondent has not yet approved Petitioner's application, hence, Petitioner filed the instant Petition for Review to toll the running of the prescriptive period for claiming a refund.

CTA Case No. 5898 was filed with this Court on June 30, 1999 while CTA Case No. 5937 was filed on September 29, 1999.

For his part, Respondent accordingly filed an Answer with Special and Affirmative Defenses on July 14, 1999 (for CTA Case No. 5898) and October 19, 1999 (for CTA Case No. 5937).

After considering the stipulated issues presented by the parties, this Court deemed it proper to summarize them into one main pivotal issue of "WHETHER OR NOT PETITIONER IS ENTITLED TO THE REFUND OR TAX CREDIT OF P868,598.89 ALLEGEDLY REPRESENTING PETITIONER'S EXCESS OR UNUTILIZED CREDITABLE INPUT VAT AS OF SEPTEMBER 30, 1997, ARISING FROM ITS DOMESTIC PURCHASES OF GOODS AND SERVICES AND ON CAPITAL GOODS IMPORTED OR LOCALLY PURCHASED."

The refund of unutilized or excess creditable input VAT from domestic purchases of capital goods finds legal support in Section 106(a)(b) of the 1995 National Internal Revenue Code, hereunder quoted as follows:

> **Section 106.** ***Refunds or tax credits of creditable input tax.*** –
>
> (a) Any VAT-registered person, whose sales are zero-rated or effectively zero-rated, may, within two (2) years after the close of the taxable quarter when the sales were made, apply for the issuance of a tax credit certificate or refund of creditable input tax due or paid attributable to such sales, except transitional input tax, to the extent that such input tax has not been applied against output tax: *Provided, however*, That in the case of zero-rated sales under Section 100(a)(2)(A)(i),(ii) and (b) and Section 102(b)(1) and (2), the acceptable foreign currency exchange proceeds thereof had been duly accounted for in accordance with the regulations of the Bangko Sentral ng Pilipinas (BSP): *Provided, further*, That where the taxpayer is engaged in zero-rated or effectively zero-rated sale and also in taxable or exempt sale of goods or properties or services, and the amount of creditable input tax due or paid cannot be directly and entirely attributed to

> any one of the transactions, it shall be allocated proportionately on the basis of the volume of sales.
>
> (b) Capital goods. - A VAT-registered person may apply for the issuance of a tax credit certificate or refund of input taxes paid on capital goods imported or locally purchased, to the extent that such input taxes have not been applied against output taxes. The application may be made only within two (2) years after the close of the taxable quarter when the importation or purchase was made.

Based on the foregoing provisions of law, Petitioner may file a claim for refund of its excess creditable input VAT on its domestic purchase and importation of capital goods if the following requirements are satisfied, to wit:

1. That the applicant must be a VAT-registered person;
2. That there be domestic purchase or importation of capital goods;
3. That the domestic purchase or importation of capital goods is substantiated by sufficient evidence;
4. That the input taxes have not been applied against the output taxes; and
5. That the application for the refund of unutilized or excess creditable input VAT arising from the domestic purchase and importation of capital goods has been made within two years after the close of the taxable quarter in which the importation or purchase was made.

There is no doubt with regard to Petitioner's compliance with the first, fourth and fifth requirement. The documentary evidence submitted to this Court would attest to the fact that Petitioner is indeed a VAT-registered taxpayer as evidenced by the BIR Certificate of Registration dated April 1, 1997 and with RDO Control No. 97-107-

0021045 VAT (see Exhs. B, B-1 and B-3). The various quarterly VAT returns presented by Petitioner likewise shows that the creditable input VAT generated during the 3rd and 4th quarters of 1997 have not been applied against its output VAT liability for the said quarter (see Exhs. C, C-4, C-6). Neither the same creditable input VAT were carried forward to the subsequent quarter (4th quarter of 1997) nor applied against any output VAT liability therein (Exh. H).

As to the question of prescription, records would reveal that both the administrative action as well as the judicial recourse undertaken by Petitioner were made within two years after the close of the taxable quarter in which the importation or purchase was made, thus:

CTA Case No.	Close of the Taxable Quarter	Administrative filing with BIR	Judicial filing with CTA	Remarks
5898	June 30, 1997	June 28, 1999	June 30, 1999	filed on time
5937	September 30, 1997	August 19, 1999	September 29, 1999	filed on time

The table above explicitly shows the timeliness of Petitioner's action with the BIR and with this Court.

We will now proceed to resolve the crucial issue (in connection with the second requirement, as stated) of whether or not the purchases made by Petitioner could be classified as capital goods based on the definition provided under Section 4.106-1(b) of Revenue Regulations No. 7-95. In the said regulation, capital goods or properties are referred to as goods and properties with estimated useful life of greater than one (1) year and which are treated as depreciable assets under Section 29(f), used directly or indirectly in the production or sale of taxable goods and services (emphasis ours). Corollarily, Section 29(f) of the Tax Code provides:

> "(f) **Depreciation.** (1) *General Rule.* - There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including reasonable allowance for obsolescence) of property used in the trade or business."

It could be recalled that in the case at bar, Petitioner is claiming for a refund of input taxes it paid on purchases of goods that were used in the cultivation of the land for banana plantation, for the propagation and plantation of the seedlings, and for the maintenance of the plants and preservation of the fruits until harvest time (See TSN, dated March 6, 2000, pp. 7-10). It is the opinion of the Petitioner that these purchases were in the nature of capital goods.

This Court does not subscribe to the theory propounded by the Petitioner.

Our study leads us to conclude that the purchases used for the improvement of the land does not qualify as capital goods. Contrary to the definition of capital goods, land as well as the improvements introduced therein are not subject to depreciation. This view finds support in the Law of Federal Income Taxation upon which the Philippines based its laws on income taxation, thus:

> "Because land does not have a limited and determinable life, it is not subject to depreciation apart from the improvements or physical development added to it." (5 MERTENS Law of Federal Income Taxation S23A.29, Chap. 23A – page 61).

> "No depreciation is allowed unless an asset has a limited and determinable existence. The allowance for depreciation is the amount which would be set aside each year so that at the end of the asset's useful life these amounts, plus any salvage value, would equal the cost or other basis of the property. The useful life is the period over which the asset may reasonably be expected to be useful to the taxpayer in its trade or business or in the production of its income.
>
> Although exhaustion of an asset may actually be taking place, no depreciation will be permitted unless the amount of exhaustion is susceptible of measurement." (5 MERTENS Law of Federal Income Taxation S23A.57, page 105).

The purchases used for the improvement of the land which Petitioner considered as capital goods were those used for the harrowing and plowing of the land and for the digging of canals for the drainage system. It must likewise be pointed out that the Court, after an examination of the official receipts and invoices, found that Petitioner did not use heavy equipment that can be considered capital goods. What was reflected in the official receipts and invoices were small tools such as shovels and the like which cannot qualify as capital goods pursuant to existing regulations.

Furthermore, this Court does not agree with Petitioner that the goods purchased for the propagation and plantation of the seedlings, and for the maintenance of the plants and preservation of the fruits until harvest time are capital goods. Although these purchases are capitalized, they are not considered capital goods. In fact, it is very clear from the testimony of Petitioner's Accounting Manager, Mr. Reynaldo Jeminico, during the hearing held on March 6, 2000, that all of Petitioner's pre-operating expenses were charged to deferred development costs and amortized[4] at the start of its commercial operation, to quote:

ATTY. SISON:

Q. Now Mr. Witness, in relation to the operations of La Frutera, can you please describe to this Court, in summary, the nature of the purchases made in relation to the operations? Just to summarize it.

A. Just to summarize it, before commercial operations, it is called pre-operating stage. All expenses, not related to capital assets, we considered them as capital goods. This is because, all the operations that are taking place during pre-operating stage, we could not reach the commercial operation stage. We could not generate a mother plant that could bear fruits and could give us revenue during commercial stage.

What I am saying is, during the commercial stage, we don't plant anymore. We don't propagate the seed. We don't maintain its growth. All we have to rely on is the mother plant. Once these mother plants are harvested, a new generation will suckle or re-grow. In ordinary term, it is called, "child plant". This is the one which is going to take the place of the mother plant. Once this is harvested, another new one will come in. It is a continuing cycle of harvesting once you are in the commercial stage. <u>That is why all related expenses prior to commercial operation are carried in our Books under different (sic) development costs and will be amortized when commercial operation started.</u>

(TSN, dated March 6, 2000, pp. 11-12)

Based on the documents submitted, only the purchases of transportation equipment and office equipment can be considered capital goods since they are subject to depreciation, and We again base our conclusion on the Law of Federal Income Taxation, thus:

"Farm property subject to depreciation consists of buildings, machinery, equipment (other than short-lived tools) and other physical properties." (5 MERTENS Law of Federal Income Taxation S23A.97, pp. 182-183)

The Court had already ruled against Petitioner with respect to land improvement in a similarly situated case of **Luisita Park Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5754, May 21, 2001,** thus:

> "We do not agree with the Petitioner and the independent CPA that expenses related to profit development cost are in the nature of capital goods. The project development cost although classified as a capital expenditure is not within the meaning of the term "capital goods". The argument of Petitioner to the effect that roads, electrical posts and perimeter fence are assets not for sale hence should be treated as capital goods is bereft of merit. They are not among the aforementioned list of Petitioner's depreciable assets. Although the roads, electrical posts and perimeter fence are assets that cannot be sold, they are improvements needed to be completed first before Petitioner could sell or lease its developed lots. Once the development of the land is completed, the costs of these improvements will eventually be realized by the increase in the selling price of the lot, rental or lease. The improvements in the industrial park are evidently not subject to depreciation and therefore are not classified as capital goods."

It is likewise significant to note that we cannot consider the refund of input taxes attributable to export sales pursuant to Section 106 (a) of the Tax Code. Refunds of input taxes under this provision shall be allowed only upon presentation of documents evidencing the actual exportation of goods in the course of trade and business by a VAT-registered taxpayer. A thorough scrutiny of the VAT returns presented for the second and third quarters of taxable year 1997 do not reflect any export sales. True enough, records would show that Petitioner's business is still in the pre-commercial stage and has not in any way commenced its export operations. Therefore, under this light, we cannot grant a refund of input taxes attributable to export sales as there was simply no sales yet.

In sum, only the input taxes on purchases of equipment in the amount of P281,978.27 should be refunded to Petitioner. Computed below are the net creditable input VAT of Petitioner for the 2nd and 3rd quarters of 1997 which are duly substantiated by documentary evidence in the form of invoices and receipts, thus:

SUPPLIER	EXHIBIT	REFERENCE NO.		INVOICE AMOUNT		INPUT VAT
DI COMPUTER SYSTEMS, INC.	F-11	12042	P	9,500.00	P	863.64
PHILIPPINE MULTICOR, INC.	F-38	6709		345,000.00		31,363.64
ISUZU MANILA	F-40	119		760,000.00		69,090.91
ISUZU MANILA	F-42	122		535,000.00		48,636.36
INTEGRATED ASIA CORP.	F-45/F-46	8810		325,000.00		29,545.45
DAVAO IMPORT DISTRIBUTORS	F-117	137543		16,061.00		1,460.09
PHILIPPINE FUJI XEROX CORP.	F-167	214602		64,900.00		5,900.00
R. AUTOSHPERE	L-300	1994		524,300.00		47,663.64
R. AUTOSHPERE	L-306	1980		522,000.00		47,454.55
	Total		P	3,101,761.00	P	281,978.27

WHEREFORE, in view of the foregoing, the instant Petition for Review is hereby **PARTIALLY GRANTED.** Respondent is **ORDERED** to **REFUND** or **TO ISSUE A TAX CREDIT CERTIFICATE** in favor of the Petitioner the reduced amount of P281,978.27 representing the excess/unutilized creditable input VAT for the 2nd and 3rd quarters of 1997.

SO ORDERED.

AMANCIO Q. SAGA
Associate Judge

I CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

CERTIFICATION

I hereby certify that the above decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge