REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

SECOND DIVISION

CAGAYAN VALLEY DRUG CORPORATION,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 7448

Members:

CASTAÑEDA, JR., *Chairperson*
UY, *and*
PALANCA-ENRIQUEZ, *JJ.*

Promulgated:

OCT 2 4 2008
8:06 a.m.

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DECISION

CASTAÑEDA, JR., *J*.:

This *Petition for Review* is a claim for issuance of tax credit certificate in the amount of P3,984,872.39, allegedly representing unused tax credits earned for taxable year 2003, arising from the twenty percent (20%) sales discounts granted by petitioner to senior citizens on their purchases of medicines as provided in Republic Act No. (RA) 7432.

Cagayan Valley Drug Corporation (Petitioner) is a domestic corporation organized and existing under laws of the Philippines, with principal office address at No. 7 Mercury Ave., Bagumbayan, Quezon City.[1] On the other

[1] Par. 1, Joint Stipulation of Facts, *Rollo*, p. 59.

hand, respondent is the duly appointed Commissioner of Internal Revenue, with office address at the Bureau of Internal Revenue (BIR) National Office Building, Diliman, Quezon City.

Petitioner is a retailer of medicines and other pharmaceutical products. It operates seven (7) drug stores located in Tuguegarao Gonzaga; Roxas, Isabela; Cauayan, Maharlika; Tuguegarao, Gomez; Ilagan, Maharlika; Tuguegarao, Delfino and Aparri Rizal, as a franchisee under the business name and style of "Mercury Drug". It is duly licensed to operate the said drug stores by the Bureau of Foods and Drugs (BFAD), the Department of Trade and Industry (DTI), and the local government units where its drugstores are located.[2]

In its Annual Income Tax Return for taxable year 2003 filed on April 14, 2004[3], petitioner reported and treated the 20% sales discount as prepaid tax credit.[4]

On April 12, 2006, petitioner filed with respondent a request for the issuance of a tax credit certificate in the amount of P3,984,872.39, equivalent to the 20% sales discounts granted by petitioner to qualified senior citizens during taxable year 2003, in compliance with RA 7432.[5]

On April 17, 2006, petitioner elevated its claim before this Court by filing this *Petition for Review*. As of the date of the filing of the instant *Petition*, respondent has not granted petitioner's request for a tax credit certificate. *gc*

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[2] Pars. 2 and 3, *ibid.*
[3] Stamp of Receipt dated April 29, 2004.
[4] Par. 4, *ibid.*; Exhibit "C", *Rollo*, pp. 113 to 122.
[5] Annex "C", Petition for Review.

On June 2, 2006, respondent filed his *Answer*[6] and averred the following Special and Affirmative Defenses:

> "5. The claim for refund is still under examination by the Respondent Bureau of Internal Revenue;
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> 6. The burden of proof is upon the Petitioner to prove that it is entitled to the claim for refund;
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> 7. The grant of a claim for refund is tantamount to an exemption from taxation which should be strictly construed against the taxpayer and in favor of the government;
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> 8. The correct interpretation and enforcement of the provisions on the tax credits of Republic Act No. 7432, entitled 'An Act to Maximize the Contribution of Senior Citizens to Nation Building, Grant Benefits and Special Privileges and for Other Purposes' is contained in Revenue Regulations No. 2-94, specifically, Section 2, paragraph (1) so states:
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> > '(1) Tax Credits - refers to the amount representing the twenty percent (20%) discount granted to a qualified senior citizen by all establishments relative to their utilization of transportation services, hotels and seminar lodging cinema houses, concert halls, circuses, carnivals and other similar places of cultures, leisure and amusement, which discount shall be deducted by the said establishment for their gross income for income tax purposes and from their gross sales for value-added tax or other percentage tax purposes.'
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> 9. The provisions under Republic Act No. 7432, which states that the twenty percent (20%) sales discounts on purchases or medicines by senior citizens be treated as a tax credit is a misnomer as it runs counter to the solemn duty of the government to collect all taxes.
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> 10. The power of taxation is a high prerogative of sovereignty. Its relinquishment is never presumed and any reduction or diminution thereof with respect to its mode or its rate must be strictly construed and the same must be couched in clear and unmistakable terms in order that it may be applied. ***(Floro Cement Corporation vs. Gorospe, G.R. No. 46787, August 2, 1991)***;

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[6] *Rollo*, pp. 32 to 34.

> 11. In Statutory Construction, in cases of ambiguities, the principle that the contemporaneous construction of statute given by executive officers of the government whose duty is to execute it is entitled to great respect and should ordinarily control the construction, it is so firmly embedded in our jurisprudence that no authorities need be cited to support it. (Phil. Assoc. of Free Labor Unions vs. BIR). Execute (sic) officials are presumed to have familiarized themselves with all consideration pertinent to the meaning and purpose of the law and to have formed an independent, consideration pertinent to the meaning and purpose of the law and to have formed an independent, conscientious and competent expert opinion thereon ***(Richard vs. Drewry-Hughes Co. 94 S.E. 989)***."

After the approval of the parties' *Joint Stipulation of Facts*, per this Court's *Resolution* dated September 11, 2006, trial on the merits ensued.

At the hearing on May 26, 2008, upon motion of counsel for petitioner on the ground that counsel for respondent has repeatedly failed to appear in the proceedings of the case, respondent was deemed to have waived her right to present evidence and to have rested its case. Petitioner was then granted thirty days to file its *Memorandum* and respondent was granted twenty days from receipt of notice to file her *Memorandum*.

On June 24, 2008, petitioner filed its *Memorandum*.

In a *Resolution* dated March 5, 2008, this case was submitted for decision, without respondent's *Memorandum* having been filed.

As stipulated by the parties, the issues[7] for this Court's resolution are as follows:

> "1. Whether the 20% sales discount granted to senior citizens on their purchase of medicines should be treated as tax credit deductible from the tax due as provided under RA 7432 or merely as a deduction from gross income as provided under Revenue Regulations No. 2-94.

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[7] Joint Stipulation of Facts, *Rollo*, p. 60.

2. Whether or not Petitioner actually granted and is entitled to the issuance of a tax credit certificate in a total amount of P3,984,872.39 representing the discounts it granted to senior citizens on their purchases of medicines in the year 2003."

The issues will be resolved *seriatim*.

The first issue is not one of first impression.

It has already been held that (1) the 20% sales discount privilege granted to senior citizens on their purchase of medicines under RA 7432 should be treated as tax credit, *i.e.*, deductible from the tax due of the concerned entity, and (2) the term "tax credit" given under Revenue Regulations No. (RR) 2-94 cannot prevail over the provisions of RA 7432, and is therefore, void.

In *Commissioner of Internal Revenue vs. Central Luzon Drug Corporation*[8], the Supreme Court has addressed the said issue in this wise:

> "**The 20 percent discount required by the law to be given to senior citizens is a *tax credit*, not merely a *tax deduction* from the gross income or gross sale of the establishment concerned**. A *tax credit* is used by a private establishment only after the tax has been computed; a *tax deduction*, before the tax is computed. **RA 7432 unconditionally grants a *tax credit* to all covered entities**. Thus, the provisions of the revenue regulations that withdraw or modify such grant are void. Basic is the rule that administrative regulations cannot amend or revoke the law.
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> xxx xxx xxx
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> Although the term is not specifically defined in our Tax Code, *tax credit* generally refers to an amount that is 'subtracted directly from one's total tax liability.' It is an 'allowance against the tax itself' or 'a deduction from what is owed' by a taxpayer to the government. Examples of *tax credits* are withheld taxes, payments of estimated tax, and investment tax credits.
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> *Tax credit* should be understood in relation to other tax concepts. One of these is *tax deduction* – defined as a subtraction

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[8] G.R. No. 159647, April 15, 2005.

'from income for tax purposes,' or an amount that is 'allowed by law to reduce income prior to [the] application of the tax rate to compute the amount of tax which is due.' An example of a *tax deduction* is any of the allowable deductions enumerated in Section 34 of the Tax Code.

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

xxx xxx xxx

What RA 7432 grants the senior citizen is a mere discount privilege, not a *sales discount* or any of the above discounts in particular. x x x.

xxx xxx xxx

Second, the law cannot be amended by a mere regulation. In fact, a regulation that 'operates to create a rule out of harmony with the statute is a mere nullity'; it cannot prevail.

It is cardinal rule that courts 'will and should respect the contemporaneous construction placed upon a statute by the executive officers whose duty it is to enforce it . . .' In the scheme of judicial tax administration, the need for certainty and predictability in the implementation of tax laws is crucial. Our tax authorities fill in the details that 'Congress may not have the opportunity or competence to provide.' The regulations these authorities issue are relied upon by taxpayers, who are certain that these will be followed by the courts. Courts, however, will not uphold these authorities' interpretations when clearly absurd, erroneous or improper.

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

In case of conflict, the law must prevail. A 'regulation adopted pursuant to law is law.' Conversely, **a regulation or any**

portion thereof not adopted pursuant to law is no law and has neither the force nor the effect of law." (*Emphasis supplied*)

With the foregoing pronouncements, which were later sustained and affirmed by the High Court in subsequent cases[9], this Court need not belabor in addressing such a settled matter.

The Court shall then proceed to address the second issue.

In order to prove that it actually granted the 20% discount to qualified senior citizens, petitioner presented its Schedule of Monthly Net Sales for 2003[10], Summary of Prepaid Income Tax-OSCA for 2003[11], cash slips evidencing the purchases of medicines by senior citizens for 2003[12], and sample BIR and BFAD Special Record Books for 2003[13].

Pursuant to CTA Circular 1-95, as amended, Mr. Nunilon P. Tagle, an independent CPA, was commissioned by this Court to verify petitioner's claim.

In his Report[14], the total discounts given to senior citizens for taxable year 2003 were summarized as follows:

Branch	Amounts Per Book	Amounts Per Audit	Variance
Tuguegarao Gonzaga	245,053.60	175,391.64	69,661.96
Roxas Syquia	123,488.61	119,132.37	4,356.24
Tuguegarao Gomez	846,065.78	839,965.89	6,099.89
Ilagan Maharlika	717,302.79	552,116.11	165,186.68
Tuguegarao Delfino	1,088,590.18	1,079,653.02	8,937.16
Cauayan Maharlika	1,067,036.66	1,045,366.11	21,670.55

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9 *Commissioner of Internal Revenue vs. Anno Domini Drug, Inc.*, G.R. No. 167688, July 27, 2005 (Resolution); *Bicolandia Drug Corporation vs. Commissioner of Internal Revenue,* G.R. No. 142299, June 22, 2006; *Commissioner of Internal Revenue vs. Bicolandia Drug Corporation,* G.R. No. 148083, July 21, 2006; *Cagayan Valley Drug Corporation vs. Commissioner of Internal Revenue,* G.R. No. 151413, February 13, 2008; and *Commissioner of Internal Revenue vs. Central Luzon Drug Corporation,* G.R. No. 159610, June 12, 2008.

10 Exhibit "M".

11 Exhibit "N".

12 Exhibit "Q" (including sub-markings).

13 Exhibit "R".

14 Exhibit "S".

Aparri Cagayan	294,028.43	Please see Note 1[15]	294,028.43
Total	**4,381,566.05**	**3,811,625.14**	**569,940.91**

After a thorough examination of the various cash slips, in relation to petitioner's summary of sales and discounts for senior citizens and the Special Record Books for 2003, the Court finds the Report of the commissioned independent CPA to be in order. It is noted, however, that in the said Report, the 20% sales discount granted to qualified senior citizens for taxable year 2003 wherein the required details for the issuance of cash slips are complete, amounted only to P3,811,625.14. The said amount shall be further reduced by excluding the 10% VAT of P346,511.38 included therein. Thus, the resulting amount of P3,465,113.76 represents valid 20% sales discounts granted by petitioner to qualified senior citizens for taxable year 2003.

Nevertheless, in order to validly claim the said amount as tax credit, petitioner must also establish that the related gross sales to senior citizens (inclusive of the 20% discount) were declared as part of its taxable income.

For taxable year 2003, petitioner reported in its Annual Income Tax Return as sales the amount of P293,503,555.00[16], which was likewise reflected in its Audited Financial Statements for the same taxable year.[17] Based on examination of petitioner's Cash Receipts Book[18] and General Ledger[19], the sales in the amount of P293,503,555.00 included the gross sales to senior citizens relative to the claimed 20% sales discount of

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[15] Note 1 (Corresponding cash slips were allegedly lost due to fire that occurred at the branch store on November 27, 2005, per spot investigation report submitted to the chief, Bureau of Fire Protection by the office of the Municipal Fire Marshall, Aparri Fire Station, dated November 29, 2005).
[16] Exhibit "C".
[17] Exhibit "D".
[18] Exhibit "W".
[19] Exhibit "V".

P3,465,113.76. Evidently, the gross sales to senior citizens corresponding to the claimed 20% sales discounts of P3,465,113.76 formed part of petitioner's taxable income for taxable year 2003.

Considering that petitioner had an income tax liability for taxable year 2003 in the amount of P566,106.00 and failed to substantiate its prior year's excess credits in the amount of P5,591,211.00, the claimed 20% sales discounts of P3,465,113.76 shall be partially applied against the income tax due of P566,106.00. Hence, petitioner's unused tax credits arising from the 20% sales discounts it granted to senior citizens for taxable year 2003 amounted only to 2,899,007.76, computed as follows:

Gross Income	P 28,305,276.00
Less: Deductions	31,027,587.00
Taxable Income	P (2,722,311.00)
Minimum Corporate Income Tax (MCIT) Due	P 566,106.00
Less: Tax Credits	
20% Discounts Granted to Senior Citizens	3,465,113.76
Excess Tax Credits	**P 2,899,007.76**

Tax refunds (or tax credits) are in the nature of tax exemptions. As such they are regarded as in derogation of sovereign authority and to be construed *strictissimi juris* against the person or entity claiming the exemption. The burden of proof is upon him who claims the exemption in his favor and he must be able to justify his claim by the clearest grant of organic or statute law.[20]

Petitioner clearly failed to fully discharge that burden. Its failure to do so would only entitle petitioner to a tax credit certificate in the reduced amount of P2,899,007.76. ✓

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[20] *Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc., et al.,* G.R. No. 127105, June 25, 1999.

WHEREFORE, the instant *Petition for Review* is hereby **PARTIALLY GRANTED**. Accordingly, respondent is hereby **ORDERED TO ISSUE A TAX CREDIT CERTIFICATE** in favor of petitioner in the reduced amount of **TWO MILLION EIGHT HUNDRED NINETY NINE THOUSAND SEVEN AND 76/100 PESOS (P2,899,007.76)**, representing unused tax credits arising from the 20% sales discounts granted to qualified senior citizens for taxable year 2003.

SO ORDERED.

JUANITO C. CASTAÑEDA, JR.
Associate Justice

WE CONCUR:

ERLINDA P. UY
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

ATTESTATION

I attest 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's Division.

JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairperson

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, and the Division Chairperson's Attestation, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court.

ERNESTO D. ACOSTA
Presiding Justice