REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

CAGAYAN VALLEY DRUG CORPORATION (formerly known as Vas Salus Drug Corporation),
Petitioner,

- versus -

C.T.A. CASE NO. 6053

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
MAR 1 1 2002

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DECISION

This is a petition seeking for the refund or issuance of a tax credit certificate in the amount of P365,397.00 allegedly representing the twenty (20%) percent sales discounts granted to senior citizens on their purchases of medicines from Petitioner during the taxable year 1997.

The facts of the case are as follows:

Petitioner is a domestic corporation organized and existing under the laws of the Philippines with principal office address at No. 7 Mercury Avenue, Bagumbayan, Quezon City. It was incorporated in 1994 under the corporate name Vas Salus Drug Corporation as a retailer of medicines and other pharmaceutical products.

By virtue of franchise agreements executed on separate dates by Mercury Drug Corporation, Vas Salus Drug Corporation and Trinity Franchising and Management Division of the Mercury Group of Companies, Inc., Petitioner was able to operate three

(3) drugstores in Tuguegarao, Cagayan (Exhibit B), Roxas, Isabela (Exhibit C) and Bangued, Abra (Exhibit D) under the business name and style of "Mercury Drug." Petitioner was also licensed to operate these drugstores by the Bureau of Food and Drugs, the Department of Trade and Industry and the local government units where they are located. On February 11, 1998, Petitioner changed its corporate name to Cagayan Valley Drug Corporation.

In compliance with Republic Act (RA) No. 7432 entitled "An Act to Maximize the Contribution of Senior Citizens to Nation Building, Grant Benefits and Special Privileges and for Other Purposes" and its implementing rules and regulations, Petitioner granted twenty percent (20%) sales discounts to qualified senior citizens on their purchases of medicines. From January to December of 1997, the sales discounts granted totalled P371,529.00.

On April 15, 1998, Petitioner filed its Annual Income Tax Return for the taxable year 1997, declaring a loss of P354,010.00 and excess creditable withholding taxes of P626.00 (Exhibit G). According to Petitioner, instead of claiming the full amount of sales discounts as tax credit under Section 4(a) of RA 7432, it treated the same as a deduction from its gross income pursuant to Revenue Regulations No. 2-94 issued by the Respondent. Believing, however, that Revenue Regulations No. 2-94 erroneously interpreted the provision of Section 4(a) of RA 7432 which provides that "x x x private establishments may claim the cost as tax credit," Petitioner filed and computed its taxes under protest (Exhibit H).

On March 19, 1999, Petitioner filed with the Appellate Division of the Bureau of Internal Revenue a claim for tax refund or credit of its alleged overpaid income tax for the taxable year 1997 in the total amount of P365,397.00 (Exhibit I) computed as follows:

S A L E S, Net		P58,804,444.00
Add: Cost of 20% Discount to Senior Citizens		371,529.00
S A L E S, Gross		P59,175,973.00
COST OF SALES		
Merchandise Inventory, beg	4,477,359.00	
Purchases	57,506,773.00	
Merchandise Inventory, end	8,328,046.00	53,656,086.00
GROSS PROFIT		5,519,887.00
Miscellaneous Income		60,514.00
TOTAL INCOME		5,580,401.00
Operating expenses		5,528,855.00
NET INCOME BEFORE INCOME TAX		51,546.00
INCOME TAX (35%)		6,132.00
Less: TAX CREDIT (Cost of 20% Discount to Senior Citizens)		371,529.00
INCOME TAX PAYABLE		(365,397.00)
INCOME TAX ACTUALLY PAID		0.00
TAX REFUNDABLE/OVERPAID INCOME TAX		(365,397.00)

In its claim for refund filed on March 19, 1999, Petitioner argued that Section 2(i) of Revenue Regulations No. 2-94 which interpreted the tax credit provision of RA 7432 as "the amount representing the 20% discount granted to a qualified senior citizen by all establishments x x x x, which discount shall be deducted by the said establishments from their gross income for income tax purposes and from their gross sales for value-added tax or other percentage tax purposes," is erroneous because it is in disagreement with RA

7432 which clearly provides that the cost of 20% discount to senior citizens may be claimed as tax credit.

Respondent did not act on the claim for refund of Petitioner, prompting the latter to file the present case on April 6, 2000 in order to toll the running of the two-year prescriptive period.

In his Answer filed on May 8, 2000, Respondent raised the following Special and Affirmative Defenses:

> "4. The Petitioner's claim for tax refund/credit is still undergoing administrative routinary investigation/examination by the Respondent's Bureau;
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> 5. The alleged tax sought to be refunded was collected pursuant to law and pertinent BIR implementing rules and regulations; hence, the same is not refundable;
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> 6. Petitioner's allegation that it erroneously and excessively paid the tax during the year under review does not ***ipso facto*** warrant the refund/credit;
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> 7. Claims for tax refund or tax credit are construed in ***strictissimi juris*** against the taxpayer as they partake the nature of an exemption from tax, and it is incumbent upon the Petitioner to prove that it is entitled thereto under the law. Failure on the part of the Petitioner to prove the same is fatal to its claim for refund/credit;
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> 8. Petitioner must show that it has complied with the provisions of Section 204(c) and 229 of the 1997 Tax Code."

That the instant petition was timely filed is conceded (paragraph 8, Joint Stipulation of Facts). Moreover, the legal issue involved in this case on the proper treatment of the 20% discount granted to qualified senior citizens on their purchases of medicines has long been settled by this Court in a number of similar cases bearing the same issue (*Mercury Drug Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5612, promulgated January 9, 2001*; *Mercury Drug Corporation vs. Commissioner of Internal*

Revenue, CTA Case No. 5315, promulgated September 6, 2000; Trinity Franchising and Management Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5605, promulgated May 30, 2000; M.E. Holding Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5604, promulgated April 25, 2000; Vas Salus Drug Corporation vs. Commissioner of Internal Revenue, CTA Case No. 5509, promulgated November 26, 1999; Trinity Franchising and Management Corporation vs. CIR, CTA Case No. 5313, promulgated August 18, 1998; M.E. Holding Corporation vs. CIR, CTA Case No. 5314, promulgated August 17, 1998; Baliuag Drug Corporation vs. CIR, CTA Case No. 5365, promulgated May 13, 1998 and Del Rosario Drug Corporation vs. CIR, CTA Case No. 5357, promulgated April 6, 1998), foremost of which is **CTA Case No. 5367 entitled Sto. Rosario Drug Corporation vs. Commissioner of Internal Revenue, promulgated on February 16, 1998**, where We ruled that:

> "(T)he provision of Section 4 of R.A. 7432 is crystal clear – the 20% discounts granted to qualified senior citizens may be claimed as tax credit. And as a settled rule of statutory construction, when the language of the law is clear and unequivocal, the law must be taken to mean exactly what it says (***Marin vs. Nacianceno, 19 Phil. 238***). Construction and interpretation come only after it has been demonstrated that application is impossible or inadequate without them (***People vs. Mapa, G.R. No. L-22301, August 30, 1967***).
>
> It is true that the respondent has the power of subordinate legislation effected by her issuance of implementing rules and regulations such as Revenue Regulations No. 2-94 in the case at bar, but the said power is not without limit. The administrative regulation must not be in sharp conflict with the governing statute it seeks to implement (***Nestle Philippines, Inc. vs. Court of Appeals, et al, 203 SCRA 504***). Revenue Regulations No. 2-94 gave a new meaning to the phrase "tax credit," interpreting it to mean that the 20% discount granted to qualified senior citizens is an amount deductible from the establishment's gross sales, which is completely contradictory to the literal or widely accepted meaning of the said phrase, as an amount subtracted from an individual's or entity's tax liability to arrive at the total tax liability (***Black's Law Dictionary***).
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> A research made on the deliberations of the Bicameral Conference Committee with respect to the contents of Republic Act 7432 clearly shows that the real intent of the lawmakers was to treat these discounts as a tax credit rather than as a deduction as interpreted by the respondent.
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> In view of such apparent discrepancy in the interpretation of the term "tax credit," the provisions of the law under R.A. 7432 should prevail over the subordinate regulation issued by respondent under Revenue Regulations No. 2-94."

The Court of Appeals affirmed Our said ruling in the cases of **Commissioner of Internal Revenue vs. Elmas Drug Corporation, CA-G.R. SP No. 49946, promulgated on October 19, 1999, and Trinity Franchising and Management Corporation vs. Commissioner of Internal Revenue CA-G.R. SP NO. 60269, promulgated on April 4, 2001**.

And in the most recent case of **Central Luzon Drug Corporation vs. Commissioner of Internal Revenue, CA-G.R. SP No. 60057, dated May 31, 2001**, the Court of Appeals ruled that the 20% sales discounts given to senior citizens in a given year may still be claimed as tax credit despite of a loss incurred and no taxes were paid by Petitioner for the same year. Thus:

> "xxx The main thrust of R.A. 7432 is to provide assistance, benefits and privileges to senior citizens to promote their welfare. One of these privileges is the grant of a 20% discount on the purchase of medicines. By doing so, the state reduces the earnings of drugstores, which amounts to an exercise of the power of eminent domain. xxx To require drugstores to donate 20% of the value of medicines sold, in the form of a discount in prices, amounts to a "taking" under the power of eminent domain. Compensation is thus due to these drugstores and the state, by reason of lack of resources, has devised a tax credit scheme to address this concern. In this way the state does not spend a thing but still complies with its obligation to compensate the drugstores.
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> In this light, we are convinced that a tax credit due to a drug store under R.A.7432 may be carried over to succeeding taxable periods or applied to other internal revenue tax liabilities. xxx The tax credit, as a valid substitute to the traditional mode of cash payment, should, therefore, go to the drugstores in its entirety and without limitations that contradict its nature as a form of just compensation. xxx"

In the same case, the Court of Appeals likewise ruled that the full amount and not only the cost of the 20% sales discounts to senior citizens should be the basis of the tax credit:

> "Lastly, the concept of tax credit as just compensation, leads us to conclude that the term "cost" under Sec. 4(a) of R.A. 7432 refers to cost of acquisition, not the cost of medicines sold to senior citizens, which was already reduced by 20%. Just compensation is the full and fair equivalent of the property taken from the private owner by the expropriator. It is intended to fully indemnify the owner for the loss sustained. The actual, basis or market value of the property is the standard of just compensation. Among the factors considered are the cost of acquisition of the property, the current value of like properties and its actual or potential uses. Clearly, the cost of medicines sold to senior citizens, which is already discounted does not come close to the full and fair equivalent of the property taken. It should not be the basis of the tax credit."

Consequently, what is left to be determined is whether or not Petitioner was able to substantiate its claim by documentary evidence.

The auditing firm Vicente E. Reyes & Associates, through its Partner, Mr. Rene Reyes, was commissioned by this Court pursuant to CTA Circular 1-95, as amended, to verify Petitioner's claim for refund. As contained in the report of the said auditing firm (Exhibit M), out of the total claim of P371,529.00 only the amount of P370,467.70 (Exhibit M-2) was properly supported by cash slips that were complete in details.

After a careful scrutiny of the "Summary of Cash Slips/Sales Discounts Granted to Senior Citizens for the year 1997" (Exhibit O) and the supporting cash slips (pre-marked as Exhibit N), We found the said report to be in order.

Records show that Petitioner actually deducted from its 1997 gross sales only the amount of P337,753.98 out of the claimed 20% sales discounts to senior citizens of P371,529.00 resulting to a 1997 net sales of P58,804,844.13 (Exhibit E-1a). The amount of P58,804,444.00 is indicated in Petitioner's 1997 audited financial statements as "Sales, Net" (Exhibit F-1a) and in Section C, Schedule 1 of its 1997 annual income tax return as

"Gross Sales During The Year" (Exhibit G-c). As a result of said deduction, Petitioner's 1997 income tax return showed a net loss of P354,010.00 (Exhibit G).

In computing Petitioner's 1997 overpaid income tax, the total 20% sales discounts to senior citizens of P337,753.98 previously deducted by Petitioner from its gross sales shall be added back to its net sales of P58,804,844.00, since the 20% sales discounts shall no longer be treated as deductions from gross income but as tax credit. Considering, however, that the substantiated 20% sales discounts in the amount of P370,467.70 is inclusive of 10% value-added tax (VAT), it is necessary to exclude from the said amount the 10% VAT of P33,678.88, resulting to a net amount of P336,788.82 which becomes Petitioner's allowable tax credit.

A re-computation, therefore, of Petitioner's 1997 income tax liability would show that Petitioner has an income tax overpayment of P336,788.82, detailed as follows:

Net Sales		P 58,804,444.00
Add: 20% Sales Discount to Senior Citizens		337,753.98
Gross Sales		P 59,142,197.98
Less: Cost of Sales		
Merchandise inventory, beginning	P 4,477,359.00	
Purchases	57,506,773.00	
Total merchandise available for sale	P 61,984,132.00	
Less: Merchandise inventory, end	8,328,046.00	53,656,086.00
Gross Profit		P 5,486,111.98
Add: Miscellaneous Income		60,514.00
Total Income		P 5,546,625.98
Less: Operating Expenses		5,528,855.00
Net Income before Income Tax		P 17,770.98
Less: Interest Income subjected to Final Tax		34,027.00
Net Loss		P (16,256.02)
Income Tax Due		P -
Less: Tax Credit – 20% Sales discounts to Senior citizens		336,788.82
Income Tax Refundable/Overpaid Income Tax		P (336,788.82)

WHEREFORE, in view of all the foregoing, the Court finds the instant petition meritorious and in accordance with law. Accordingly, Respondent is hereby **ORDERED** to **ISSUE** a **TAX CREDIT CERTIFICATE** in favor of Petitioner in the reduced amount of P336,788.82, representing overpaid income tax for the taxable year 1997.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

(with Dissenting Opinion)
AMANCIO Q. SAGA
Associate Judge

JUANITO C. CASTAÑEDA, JR.
Associate 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