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THIRD DIVISION

[G.R. No. 153866. February 11, 2005]

COMMISSIONER OF INTERNAL REVENUE, *petitioner, vs.* **SEAGATE TECHNOLOGY (PHILIPPINES),** *respondent.*

SYLLABUS

1. TAXATION; EXEMPTION; PRE-FERENTIAL TAX TREATMENT UNDER SPECIAL LAWS; PHILIPPINE ECONOMIC ZONE AUTHORITY (PEZA)-REGISTERED ENTERPRISE WITHIN A SPECIAL ECONOMIC ZONE IS BENEFICIARY THEREOF.— As a PEZA-registered enterprise within a special economic zone, respondent is entitled to the fiscal incentives and benefits provided for in either PD 66 or EO 226. It shall, moreover, enjoy all privileges, benefits, advantages or exemptions under both Republic Act Nos. (RA) 7227 and 7844. If it avails itself of PD 66, notwithstanding the provisions of other laws to the contrary, respondent shall not be subject to internal revenue laws and regulations for raw materials, supplies, articles, equipment, machineries, spare parts and wares, except those prohibited by law, brought into the zone to be stored, broken up, repacked, assembled, installed, sorted, cleaned, graded or otherwise processed, manipulated, manufactured, mixed or used directly or indirectly in such activities. Even so, respondent would enjoy a net-operating loss carry over; accelerated depreciation; foreign exchange and financial assistance; and exemption from export taxes, local taxes and licenses. Comparatively, the same exemption from internal revenue laws and regulations applies if EO 226 is chosen. Under this law, respondent shall further be entitled to an income tax holiday; additional deduction for labor expense; simplification of customs procedure; unrestricted use of consigned equipment; access to a bonded manufacturing warehouse system; privileges for foreign nationals employed; tax credits on domestic capital equipment, as well as for taxes and duties on raw materials; and exemption from contractors' taxes, wharfage dues, taxes

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and duties on imported capital equipment and spare parts, export taxes, duties, imposts and fees, local taxes and licenses, and real property taxes. A privilege available to respondent under the provision in RA 7227 on tax and duty-free importation of raw materials, capital and equipment — is, *ipso facto*, also accorded to the zone under RA 7916. Furthermore, the latter law — notwithstanding other existing laws, rules and regulations to the contrary — extends to that zone the provision stating that no local or national taxes shall be imposed therein. No exchange control policy shall be applied; and free markets for foreign exchange, gold, securities and future shall be allowed and maintained. Banking and finance shall also be liberalized under minimum Bangko Sentral regulation with the establishment of foreign currency depository units of local commercial banks and offshore banking units of foreign banks. In the same vein, respondent benefits under RA 7844 from negotiable tax credits for locally-produced materials used as inputs. Aside from the other incentives possibly already granted to it by the Board of Investments, it also enjoys preferential credit facilities and exemption from PD 1853. From the above-cited laws, it is immediately clear that petitioner enjoys preferential tax treatment. It is not subject to internal revenue laws and regulations and is even entitled to tax credits. The VAT on capital goods is an internal revenue tax from which petitioner as an entity is exempt. Although the *transactions* involving such tax are not exempt, petitioner as a VAT-registered person, however, is entitled to their credits.

2. ID.; ID.; VALUE-ADDED TAX (VAT) AND TAX CREDIT METHOD; ELUCIDATED.— Viewed broadly, the VAT is a uniform tax ranging, at present, from 0 percent to 10 percent levied on every importation of goods, whether or not in the course of trade or business, or imposed on each sale, barter, exchange or lease of goods or properties or on each rendition of services in the course of trade or business as they pass along the production and distribution chain, the tax being limited only to the value added to such goods, properties or services by the seller, transferor or lessor. It is an indirect tax that may be shifted or passed on to the buyer, transferee or lessee of the goods, properties or services. As such, it should be understood not in the context of the person or entity that is primarily, directly and legally liable for its payment, but

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in terms of its nature as a tax on consumption. In either case, though, the same conclusion is arrived at. The law that originally imposed the VAT in the country, as well as the subsequent amendments of that law, has been drawn from the *tax credit method*. Such method adopted the mechanics and self-enforcement features of the VAT as first implemented and practiced in Europe and subsequently adopted in New Zealand and Canada. Under the present method that relies on invoices, an entity can credit against or subtract from the VAT charged on its sales or outputs the VAT paid on its purchases, inputs and imports. If at the end of a taxable quarter the output taxes charged by a seller are equal to the input taxes passed on by the suppliers, no payment is required. It is when the output taxes exceed the input taxes that the excess has to be paid. If, however, the input taxes exceed the output taxes, the excess shall be carried over to the succeeding quarter or quarters. Should the input taxes result from zero-rated or effectively zero-rated transactions or from the acquisition of capital goods, any excess over the output taxes shall instead be refunded to the taxpayer or credited against other internal revenue taxes.

3. **ID.; ID.; ID.; ZERO-RATED TRANSACTIONS DISTINGUISHED FROM EFFECTIVELY ZERO-RATED TRANSACTIONS. –** Although both are taxable and similar in effect, zero-rated transactions differ from effectively zero-rated transactions as to their source. Zero-rated transactions generally refer to the export sale of goods and supply of services. The tax rate is set at zero. When applied to the tax base, such rate obviously results in no tax chargeable against the purchaser. The seller of such transactions charges no output tax, but can claim a refund of or a tax credit certificate for the VAT previously charged by suppliers. Effectively zero-rated transactions, however, refer to the sale of goods or supply of services to persons or entities whose exemption under special laws or international agreements to which the Philippines is a signatory effectively subjects such transactions to a zero rate. Again, as applied to the tax base, such rate does not yield any tax chargeable against the purchaser. The seller who charges zero output tax on such transactions can also claim a refund of or a tax credit certificate for the VAT previously charged by suppliers.

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4. ID.; ID.; ID.; ID.; ZERO RATING AND EXEMPTION; EXTENT OF RELIEF THEREOF APPLYING THE DESTINATION PRINCIPLE TO EXPORTATION OF GOODS.— In terms of the VAT *computation*, zero rating and exemption are the same, but the *extent of relief* that results from either one of them is not. Applying the *destination principle* to the exportation of goods, automatic zero rating is primarily intended to be enjoyed by the seller who is directly and legally liable for the VAT, making such seller internationally competitive by allowing the refund or credit of input taxes that are attributable to export sales. Effective zero rating, on the contrary, is intended to benefit the purchaser who, not being directly and legally liable for the payment of the VAT, will ultimately bear the burden of the tax shifted by the suppliers. In both instances of zero rating, there is *total relief* for the purchaser from the burden of the tax. But in an exemption there is only *partial relief*, because the purchaser is not allowed any tax refund of or credit for input taxes paid.

5. ID.; ID.; VAT; OBJECT OF EXEMPTION; EXEMPT TRANSACTION AND EXEMPT PARTY; ELUCIDATED. — The object of exemption from the VAT may either be the transaction itself or any of the parties to the transaction. An *exempt transaction*, on the one hand, involves goods or services which, by their nature, are specifically listed in and expressly exempted from the VAT under the Tax Code, without regard to the tax status — VAT-exempt or not — of the party to the transaction. Indeed, such *transaction* is not subject to the VAT, but the seller is not allowed any tax refund of or credit for any input taxes paid. An *exempt party*, on the other hand, is a person or entity granted VAT exemption under the Tax Code, a special law or an international agreement to which the Philippines is a signatory, and by virtue of which its taxable transactions become exempt from the VAT. Such *party* is also not subject to the VAT, but may be allowed a tax refund of or credit for input taxes paid, depending on its registration as a VAT or non-VAT taxpayer. As mentioned earlier, the VAT is a tax on consumption, the amount of which may be shifted or passed on by the seller to the purchaser of the goods, properties or services. While the *liability* is imposed on one person, the *burden* may be passed on to another.

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Therefore, if a special law merely exempts a party as a *seller from its direct liability* for payment of the VAT, but does not relieve the same party as a *purchaser from its indirect burden* of the VAT shifted to it by its VAT-registered suppliers, the purchase *transaction* is not exempt. Applying this principle to the case at bar, the purchase *transactions* entered into by respondent are not VAT-exempt.

6. ID.; ID.; TAX CODE; SALE TRANSACTIONS FALLING UNDER PD 66 ARE NOT EXEMPT FROM VAT BUT WILL EITHER BE ZERO-RATED OR TAXED AT STANDARD RATE OF 10% DEPENDING ON DESTINATION PRINCIPLE.— Special laws may certainly exempt transactions from the VAT. However, the Tax Code provides that those falling under PD 66 are not. PD 66 is the precursor of RA 7916 — the special law under which respondent was registered. The purchase *transactions* it entered into are, therefore, not VAT-exempt. These are subject to the VAT; respondent is required to register. Its sales transactions, however, will either be zero-rated or taxed at the standard rate of 10 percent, depending again on the application of the *destination principle*. If respondent enters into such sales transactions with a purchaser — usually in a foreign country — for use or consumption outside the Philippines, these shall be subject to 0 percent. If entered into with a purchaser for use or consumption in the Philippines, then these shall be subject to 10 percent, unless the purchaser is exempt from the indirect burden of the VAT, in which case it shall also be zero-rated.

7. ID.; ID.; ID.; ID.; ZERO RATE APPLIED TO RESPONDENT AS THE ECOZONE WITHIN WHICH IT IS REGISTERED IS MANAGED AND OPERATED BY THE PEZA AS A SEPARATE CUSTOMS TERRITORY.— Since the purchases of respondent are not exempt from the VAT, the rate to be applied is zero. Its exemption under both PD 66 and RA 7916 effectively subjects such transactions to a zero rate, because the ecozone within which it is registered is managed and operated by the PEZA as a *separate customs territory*. This means that in such zone is created the legal fiction of foreign territory. Under the *cross-border principle* of the VAT system being enforced by the Bureau of Internal Revenue (BIR), no VAT shall be imposed to form part of

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the cost of goods destined for consumption outside of the territorial border of the taxing authority. If exports of goods and services from the Philippines to a foreign country are free of the VAT, then the same rule holds for such exports from the national territory — except specifically declared areas — to an ecozone. Sales made by a VAT-registered person in the customs territory to a PEZA-registered entity are considered exports to a foreign country; conversely, sales by a PEZA-registered entity to a VAT-registered person in the customs territory are deemed imports from a foreign country. An ecozone — indubitably a geographical territory of the Philippines — is, however, regarded in law as foreign soil. This legal fiction is necessary to give meaningful effect to the policies of the special law creating the zone. If respondent is located in an export processing zone within that ecozone, sales to the export processing zone, even without being actually exported, shall in fact be viewed as *constructively exported* under EO 226. Considered as export sales, such purchase transactions by respondent would indeed be subject to a zero rate.

8. ID.; ID.; ID.; ID.; ID.; TAX EXEMPTIONS OF RESPONDENT; DISCUSSED.— Respondent as an entity is exempt from internal revenue laws and regulations. This exemption covers *both* direct and indirect taxes, stemming from the very nature of the VAT as a tax on consumption, for which the direct *liability* is imposed on one person but the indirect *burden* is passed on to another. Respondent, as an exempt entity, can neither be directly charged for the VAT on its sales nor indirectly made to bear, as added cost to such sales, the equivalent VAT on its purchases. *Ubi lex non distinguit, nec nos distinguere debemus*. Where the law does not distinguish, we ought not to distinguish. Moreover, the exemption is both express and pervasive. To be sure, statutes that grant tax exemptions are construed *strictissimi juris* against the taxpayer and liberally in favor of the taxing authority. Tax refunds are in the nature of such exemptions. Accordingly, the claimants of those refunds bear the burden of proving the factual basis of their claims; and of showing, by words too plain to be mistaken, that the legislature intended to exempt them. In the present case, all the cited legal provisions are teeming with life with respect to the grant of tax exemptions too vivid to pass unnoticed.

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In addition, respondent easily meets the challenge. Respondent, which as an entity is exempt, is different from its transactions which are not exempt. The end result, however, is that it is not subject to the VAT. The non-taxability of transactions that are otherwise taxable is merely a necessary incident to the tax exemption conferred by law upon it as an entity, not upon the transactions themselves. Nonetheless, its exemption as an entity and the non-exemption of its transactions lead to the same result.

9. ID.; ID.; ID.; EXEMPTION; PEZA LAW, UPHELD AS AGAINST REQUIREMENT OF REGISTRATION AND APPLICATION.— The PEZA law, which carried over the provisions of the EPZA law, is clear in exempting from internal revenue laws and regulations the equipment — including capital goods — that registered enterprises will use, directly or indirectly, in manufacturing. EO 226 even reiterates this privilege among the incentives it gives to such enterprises. Registration does not determine taxability under the VAT law. Moreover, the facts have already been determined by the lower courts. Having failed to present evidence to support its contentions against the *income tax holiday* privilege of respondent, petitioner is deemed to have conceded. It is a cardinal rule that "issues and arguments not adequately and seriously brought below cannot be raised for the first time on appeal." This is a "matter of procedure" and a "question of fairness." Failure to assert "within a reasonable time warrants a presumption that the party entitled to assert it either has abandoned or declined to assert it." The BIR regulations additionally requiring an approved prior application for effective zero rating cannot prevail over the clear VAT nature of respondent's transactions. The scope of such regulations is not "within the statutory authority xxx granted by the legislature.

10. ID.; ID.; ID.; ID.; TAX REFUND OR CREDIT PROPER AS RESPONDENT'S PURCHASE TRANSACTIONS SUBJECT TO ZERO VAT RATE, ESTABLISHED; CASE AT BAR. – Having determined that respondent's purchase transactions are subject to a zero VAT rate, the tax refund or credit is in order. As correctly held by both the CA and the Tax Court, respondent had chosen the fiscal incentives in EO 226 over those in RA 7916 and PD 66. It opted for

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the *income tax holiday regime* instead of the 5 percent *preferential tax regime*. The latter scheme is not a perfunctory aftermath of a simple registration under the PEZA law, for EO 226 also has provisions to contend with. These two regimes are in fact incompatible and cannot be availed of simultaneously by the same entity. While EO 226 merely exempts it from income taxes, the PEZA law exempts it from all taxes. Therefore, respondent can be considered exempt, not from the VAT, but only from the payment of income tax for a certain number of years, depending on its registration as a pioneer or a non-pioneer enterprise. Besides, the remittance of the aforesaid 5 percent of gross income earned in lieu of local and national taxes imposable upon business establishments within the ecozone cannot outrightly determine a VAT exemption. Being subject to VAT, payments erroneously collected thereon may then be refunded or credited. Even if it is argued that respondent is subject to the 5 percent *preferential tax regime* in RA 7916, Section 24 thereof does not preclude the VAT. One can, therefore, counterargue that such provision merely exempts respondent from taxes imposed on business. To repeat, the VAT is a tax imposed on consumption, not on business. Although respondent as an entity is exempt, the transactions it enters into are not necessarily so. The VAT payments made in excess of the zero rate that is imposable may certainly be refunded or credited. And as further enunciated by the Tax Court, respondent complied with all the requisites for claiming a VAT refund or credit.

APPEARANCES OF COUNSEL

The Litigation Division (BIR) for petitioner.
Quisumbing Torres for respondent.

D E C I S I O N

PANGANIBAN, *J.*:

Business companies registered in and operating from the Special Economic Zone in Naga, Cebu — like herein respondent — are *entities* exempt from all internal revenue taxes and the

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implementing rules relevant thereto, including the value-added taxes or VAT. Although export sales are not deemed exempt *transactions*, they are nonetheless zero-rated. Hence, in the present case, the distinction between exempt *entities* and exempt *transactions* has little significance, because the net result is that the taxpayer is not liable for the VAT. Respondent, a VAT-registered enterprise, has complied with all requisites for claiming a tax refund of or credit for the input VAT it paid on capital goods it purchased. Thus, the Court of Tax Appeals and the Court of Appeals did not err in ruling that it is entitled to such refund or credit.

The Case

Before us is a Petition for Review[1] under Rule 45 of the Rules of Court, seeking to set aside the May 27, 2002 Decision[2] of the Court of Appeals (CA) in CA-GR SP No. 66093. The decretal portion of the Decision reads as follows:

"**WHEREFORE**, foregoing premises considered, the petition for review is **DENIED** for lack of merit."[3]

The Facts

The CA quoted the facts narrated by the Court of Tax Appeals (CTA), as follows:

"As jointly stipulated by the parties, the pertinent facts xxx involved in this case are as follows:

1. [Respondent] is a resident foreign corporation duly registered with the Securities and Exchange Commission to do business in the Philippines, with principal office address at the new Cebu Township One, Special Economic Zone, Barangay Cantao-an, Naga, Cebu;

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[1] *Rollo*, pp. 8-20.

[2] *Id.*, pp. 21-30. Thirteenth Division. Penned by Justice Mercedes Gozo-Dadole, with the concurrence of Justices Salvador J. Valdez Jr. (chair) and Amelita G. Tolentino (member).

[3] CA Decision, p. 10; *rollo*, p. 30. Bold types and caps in the original.

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2. [Petitioner] is sued in his official capacity, having been duly appointed and empowered to perform the duties of his office, including, among others, the duty to act and approve claims for refund or tax credit;

3. [Respondent] is registered with the Philippine Export Zone Authority (PEZA) and has been issued PEZA Certificate No. 97-044 pursuant to Presidential Decree No. 66, as amended, to engage in the manufacture of recording components primarily used in computers for export. Such registration was made on 6 June 1997;

4. [Respondent] is VAT [(Value Added Tax)]-registered entity as evidenced by VAT Registration Certification No. 97-083-000600-V issued on 2 April 1997;

5. VAT returns for the period 1 April 1998 to 30 June 1999 have been filed by [respondent];

6. An administrative claim for refund of VAT input taxes in the amount of ₱28,369,226.38 with supporting documents (inclusive of the ₱12,267,981.04 VAT input taxes subject of this Petition for Review), was filed on 4 October 1999 with Revenue District Office No. 83, Talisay Cebu;

7. No final action has been received by [respondent] from [petitioner] on [respondent's] claim for VAT refund.

"The administrative claim for refund by the [respondent] on October 4, 1999 was not acted upon by the [petitioner] prompting the [respondent] to elevate the case to [the CTA] on July 21, 2000 by way of Petition for Review in order to toll the running of the two-year prescriptive period.

"For his part, [petitioner] xxx raised the following Special and Affirmative Defenses, to wit:

1. [Respondent's] alleged claim for tax refund/credit is subject to administrative routinary investigation/examination by [petitioner's] Bureau;

2. Since 'taxes are presumed to have been collected in accordance with laws and regulations,' the [respondent] has the burden of proof that the taxes sought to be refunded were erroneously or illegally collected xxx;

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3. In *Citibank, N.A. vs. Court of Appeals*, 280 SCRA 459 (1997), the Supreme Court ruled that:

> "A claimant has the burden of proof to establish the factual basis of his or her claim for tax credit/refund."

4. Claims for tax refund/tax credit are construed in '*strictissimi juris*' against the taxpayer. This is due to the fact that claims for refund/credit [partake of] the nature of an exemption from tax. Thus, it is incumbent upon the [respondent] to prove that it is indeed entitled to the refund/credit sought. Failure on the part of the [respondent] to prove the same is fatal to its claim for tax credit. He who claims exemption must be able to justify his claim by the clearest grant of organic or statutory law. An exemption from the common burden cannot be permitted to exist upon vague implications;

5. Granting, without admitting, that [respondent] is a Philippine Economic Zone Authority (PEZA) registered Ecozone Enterprise, then its business is not subject to VAT pursuant to Section 24 of Republic Act No. ([RA]) 7916 in relation to Section 103 of the Tax Code, as amended. As [respondent's] business is not subject to VAT, the capital goods and services it alleged to have purchased are considered not used in VAT taxable business. As such, [respondent] is not entitled to refund of input taxes on such capital goods pursuant to Section 4.106.1 of Revenue Regulations No. ([RR])7-95, and of input taxes on services pursuant to Section 4.103 of said regulations.

6. [Respondent] must show compliance with the provisions of Section 204 (C) and 229 of the 1997 Tax Code on filing of a written claim for refund within two (2) years from the date of payment of tax.'

"On July 19, 2001, the Tax Court rendered a decision granting the claim for refund."[4]

Ruling of the Court of Appeals

The CA affirmed the Decision of the CTA granting the claim for refund or issuance of a tax credit certificate (TCC) in favor

[4] CA Decision, pp. 2-4; *rollo*, pp. 22-24. Citations omitted.

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of respondent in the reduced amount of ₱12,122,922.66. This sum represented the unutilized but substantiated input VAT paid on capital goods purchased for the period covering April 1, 1998 to June 30, 1999.

The appellate court reasoned that respondent had availed itself only of the fiscal incentives under Executive Order No. (EO) 226 (otherwise known as the Omnibus Investment Code of 1987), not of those under both Presidential Decree No. (PD) 66, as amended, and Section 24 of RA 7916. Respondent was, therefore, considered exempt only from the payment of income tax when it opted for the income tax holiday in lieu of the 5 percent preferential tax on gross income earned. As a VAT-registered entity, though, it was still subject to the payment of other national internal revenue taxes, like the VAT.

Moreover, the CA held that neither Section 109 of the Tax Code nor Sections 4.106-1 and 4.103-1 of RR 7-95 were applicable. Having paid the input VAT on the capital goods it purchased, respondent correctly filed the administrative and judicial claims for its refund within the two-year prescriptive period. Such payments were — to the extent of the refundable value — duly supported by VAT invoices or official receipts, and were not yet offset against any output VAT liability.

Hence this Petition.[5]

Sole Issue

Petitioner submits this sole issue for our consideration:

"Whether or not respondent is entitled to the refund or issuance of Tax Credit Certificate in the amount of ₱12,122,922.66 representing alleged unutilized input VAT paid on capital goods purchased for the period April 1, 1998 to June 30, 1999."[6]

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[5] The Petition was deemed submitted for decision on April 3, 2003, upon receipt by the Court of petitioner's Memorandum, signed by Assistant Solicitors General Cecilio O. Estoesta and Fernanda Lampas Peralta and Associate Solicitor Romeo D. Galzote. Respondent's Memorandum, signed by Attys. Dennis G. Dimagiba and Franklin A. Prestousa, was filed on March 7, 2003.

[6] Petitioner's Memorandum, p. 5; *rollo*, p. 99. Original in upper case.

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The Court's Ruling

The Petition is unmeritorious.

Sole Issue:
Entitlement of a VAT-Registered PEZA Enterprise to a Refund of or Credit for Input VAT

No doubt, as a PEZA-registered enterprise within a special economic zone,[7] respondent is entitled to the fiscal incentives and benefits[8] provided for in either PD 66 [9] or EO 226. [10] It shall, moreover, enjoy all privileges, benefits, advantages or exemptions under both Republic Act Nos. (RA) 7227[11] and 7844.[12]

Preferential Tax Treatment Under Special Laws

If it avails itself of PD 66, notwithstanding the provisions of other laws to the contrary, respondent shall not be subject to internal revenue laws and regulations for raw materials, supplies, articles, equipment, machineries, spare parts and wares, except those prohibited by law, brought into the zone to be stored, broken up, repacked, assembled, installed, sorted, cleaned, graded or otherwise processed, manipulated, manufactured, mixed or used directly or indirectly in such activities.[13] Even so, respondent

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[7] Referred to as ecozone, it is a selected area with highly developed, or which has the potential to be developed into, agro-industrial, industrial, tourist/ recreational, commercial, banking, investment and financial centers. §4(a), Chapter I of RA 7916, otherwise known as "The Special Economic Zone Act of 1995."

[8] §35, Chapter III of RA 7916.

[9] PD 66 is the law creating the Export Processing Zone Authority or EPZA. See 1st paragraph of §23, Chapter III of RA 7916.

[10] EO 226, in Article 1 thereof, is also known as the "Omnibus Investments Code" of 1987. See 1st paragraph of §23, Chapter III of RA 7916.

[11] RA 7227, in §1 thereof, is also known as the "Bases Conversion and Development Act of 1992." See §51, Chapter VI of RA 7916.

[12] RA 7844, in §1 thereof, is also known as the "Export Development Act of 1994." See 2nd paragraph of §23, Chapter III of RA 7916.

[13] §17(1) of PD 66.

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would enjoy a net-operating loss carry over; accelerated depreciation; foreign exchange and financial assistance; and exemption from export taxes, local taxes and licenses.[14]

Comparatively, the same exemption from internal revenue laws and regulations applies if EO 226[15] is chosen. Under this law, respondent shall further be entitled to an income tax holiday; additional deduction for labor expense; simplification of customs procedure; unrestricted use of consigned equipment; access to a bonded manufacturing warehouse system; privileges for foreign nationals employed; tax credits on domestic capital equipment, as well as for taxes and duties on raw materials; and exemption from contractors' taxes, wharfage dues, taxes and duties on imported capital equipment and spare parts, export taxes, duties, imposts and fees,[16] local taxes and licenses, and real property taxes.[17]

A privilege available to respondent under the provision in RA 7227 on tax and duty-free importation of raw materials, capital and equipment[18] — is, *ipso facto*, also accorded to the zone[19] under RA 7916. Furthermore, the latter law — notwithstanding other existing laws, rules and regulations to the contrary — extends[20] to that zone the provision stating that no local or national taxes shall be imposed therein.[21] No exchange control policy shall be applied; and free markets for foreign

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[14] §18 of PD 66.

[15] Article 77(1), Book VI of EO 226.

[16] Article 39 of EO 226, certain paragraphs of which are expressly repealed by the 2nd paragraph of §20 of RA 7716, otherwise known as the "Expanded Value Added Tax Law," deemed effective May 27, 1994. See *Commissioner of Internal Revenue v. Michel J. Lhuillier Pawnshop, Inc.*, 406 SCRA 178, 187, July 15, 2003.

[17] Article 78 of EO 226.

[18] (b) of the 2nd paragraph of §12 of RA 7227.

[19] §51, Chapter VI of RA 7916.

[20] §51, Chapter VI of RA 7916.

[21] (c) of the 2nd paragraph of §12 of RA 7227.

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exchange, gold, securities and future shall be allowed and maintained.[22] Banking and finance shall also be liberalized under minimum Bangko Sentral regulation with the establishment of foreign currency depository units of local commercial banks and offshore banking units of foreign banks.[23]

In the same vein, respondent benefits under RA 7844 from negotiable tax credits[24] for locally-produced materials used as inputs. Aside from the other incentives possibly already granted to it by the Board of Investments, it also enjoys preferential credit facilities[25] and exemption from PD 1853.[26]

From the above-cited laws, it is immediately clear that petitioner enjoys preferential tax treatment.[27] It is not subject to internal revenue laws and regulations and is even entitled to tax credits. The VAT on capital goods is an internal revenue tax from which petitioner as an entity is exempt. Although the *transactions* involving such tax are not exempt, petitioner as a VAT-registered person,[28] however, is entitled to their credits.

Nature of the VAT and the Tax Credit Method

Viewed broadly, the VAT is a uniform tax ranging, at present, from 0 percent to 10 percent levied on every importation of goods, whether or not in the course of trade or business, or

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[22] (d) of the 2nd paragraph of §12 of RA 7227.

[23] Referred to as the Central Bank under (e) of the 2nd paragraph of §12 of RA 7227.

[24] §17 of RA 7844.

[25] §16 of RA 7844. See 2nd paragraph of §23, Chapter III of RA 7916.

[26] PD 1853 was the law that took effect in 1983, requiring deposits of duties upon the opening of letters of credit to cover imports.

[27] 2nd paragraph of §4, Chapter I of RA 7916.

[28] A "VAT-registered person" is a taxable person who has registered for VAT purposes under §236 of the Tax Code. Deoferio and Mamalateo, The Value Added Tax in the Philippines (1st ed., 2000), p. 265. See 9th paragraph of §4.107-1(a) of Revenue Regulations No. (RR) 7-95, implemented beginning January 1, 1996, as amended by §6 of RR 6-97, effective January 1, 1997.

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imposed on each sale, barter, exchange or lease of goods or properties or on each rendition of services in the course of trade or business[29] as they pass along the production and distribution chain, the tax being limited only to the value added[30] to such goods, properties or services by the seller, transferor or lessor.[31] It is an indirect tax that may be shifted or passed on to the buyer, transferee or lessee of the goods, properties or services.[32] As such, it should be understood not in the context of the person or entity that is primarily, directly and legally liable for its payment, but in terms of its nature as a tax on consumption.[33] In either case, though, the same conclusion is arrived at.

The law[34] that originally imposed the VAT in the country, as well as the subsequent amendments of that law, has been drawn from the *tax credit method*.[35] Such method adopted the mechanics and self-enforcement features of the VAT as first implemented and practiced in Europe and subsequently adopted in New Zealand and Canada.[36] Under the present method that relies on invoices, an entity can credit against or subtract from the VAT charged on its sales or outputs the VAT paid on its purchases, inputs and imports.[37]

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[29] §§105 to 109 of RA 8424, as amended, otherwise known as the Tax Code.

[30] *Kapatiran ng mga Naglilingkod sa Pamahalaan ng Pilipinas, Inc.*, 163 SCRA 371, 378-379, June 30, 1988.

[31] De Leon, The Fundamentals of Taxation (12th ed., 1998), p. 131.

[32] 2nd paragraph of §105 of the Tax Code.

[33] Deoferio Jr. and Mamalateo, *The Value Added Tax in the Philippines* (1st ed., 2000), pp. 33 & 36.

[34] EO 273.

[35] Vitug, *J.* and Acosta, *Tax Law and Jurisprudence* (2nd ed., 2000), p. 227.

See §193(d) of the National Internal Revenue Code of 1977 as further amended by §1 of Pres. Decree No. 1358 dated April 21, 1978, wherein the *tax credit method*, instead of the *cost deduction method*, was mandated to be applied in computing the VAT due.

[36] Deoferio Jr. and Mamalateo, *supra*, p. 34.

[37] *Id.*, pp. 34-35.

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If at the end of a taxable quarter the output taxes[38] charged by a seller[39] are equal to the input taxes[40] passed on by the suppliers, no payment is required. It is when the output taxes exceed the input taxes that the excess has to be paid.[41] If, however, the input taxes exceed the output taxes, the excess shall be carried over to the succeeding quarter or quarters.[42] Should the input taxes result from zero-rated or effectively zero-rated transactions or from the acquisition of capital goods,[43] any excess over the output taxes shall instead be refunded[44] to the taxpayer or credited[45] against other internal revenue taxes.[46]

Zero-Rated and Effectively Zero-Rated Transactions

Although both are taxable and similar in effect, zero-rated transactions differ from effectively zero-rated transactions as to their source.

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[38] "Output taxes" refer to the VAT due on the sale or lease of taxable goods, properties or services by a VAT-registered or VAT-registrable person. See last paragraph of §110(A)(3) and §236 of the Tax Code.

[39] Presumed to be VAT-registered.

[40] By "input taxes" is meant the VAT due from or paid by a VAT-registered person in the course of trade or business on the importation of goods or local purchases of goods or services, including the lease or use of property from a VAT-registered person. *See* penultimate paragraph of §110(A)(3) of the Tax Code.

[41] §110(B) of the Tax Code.

VAT-registered persons shall pay the VAT on a monthly basis. §114(A) of the Tax Code.

[42] §110(B) of the Tax Code.

[43] These are goods or properties with estimated useful lives greater than one year and which are treated as depreciable assets under §34(F) [formerly §29(f)] of the Tax Code, used directly or indirectly in the production or sale of taxable goods or services. 3rd paragraph of §4.106-1(b) of RR 7-95.

These goods also refer to "capital assets" as this term is defined in §39(A)(1) of the Tax Code.

[44] De Leon, p. 135.

[45] Deoferio Jr. and Mamalateo, *supra*, p. 244.

[46] Subject to the provisions of §§106, 108 and 112 of the Tax Code.

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Zero-rated transactions generally refer to the export sale of goods and supply of services.[47] The tax rate is set at zero.[48] When applied to the tax base, such rate obviously results in no tax chargeable against the purchaser. The seller of such transactions charges no output tax,[49] but can claim a refund of or a tax credit certificate for the VAT previously charged by suppliers.

Effectively zero-rated transactions, however, refer to the sale of goods[50] or supply of services[51] to persons or entities whose exemption under special laws or international agreements to which the Philippines is a signatory effectively subjects such transactions to a zero rate.[52] Again, as applied to the tax base, such rate does not yield any tax chargeable against the purchaser. The seller who charges zero output tax on such transactions can also claim a refund of or a tax credit certificate for the VAT previously charged by suppliers.

Zero Rating and Exemption

In terms of the VAT *computation*, zero rating and exemption are the same, but the *extent of relief* that results from either one of them is not.

Applying the *destination principle*[53] to the exportation of goods, automatic zero rating[54] is primarily intended to be enjoyed by the seller who is directly and legally liable for the VAT,

[47] De Leon, p. 133.

[48] Deoferio Jr. and Mamalateo, *supra*, p. 190.

[49] De Leon, p. 133.

[50] §106(A)(2)(c) of the Tax Code.

[51] §108(B)(3) of the Tax Code.

[52] Deoferio Jr. and Mamalateo, *supra*, p. 215.

[53] Under this principle, goods and services are taxed only in the country where these are consumed. Thus, exports are zero-rated, but imports are taxed. *Id.*, p. 43.

[54] In business parlance, "automatic zero rating" refers to the standard zero rating as provided for in the Tax Code.

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making such seller internationally competitive by allowing the refund or credit of input taxes that are attributable to export sales.[55] Effective zero rating, on the contrary, is intended to benefit the purchaser who, not being directly and legally liable for the payment of the VAT, will ultimately bear the burden of the tax shifted by the suppliers.

In both instances of zero rating, there is *total relief* for the purchaser from the burden of the tax.[56] But in an exemption there is only *partial relief*,[57] because the purchaser is not allowed any tax refund of or credit for input taxes paid.[58]

Exempt Transaction and Exempt Party

The object of exemption from the VAT may either be the transaction itself or any of the parties to the transaction.[59]

An *exempt transaction*, on the one hand, involves goods or services which, by their nature, are specifically listed in and expressly exempted from the VAT under the Tax Code, without regard to the tax status — VAT-exempt or not — of the party to the transaction.[60] Indeed, such *transaction* is not subject to the VAT, but the seller is not allowed any tax refund of or credit for any input taxes paid.

An *exempt party*, on the other hand, is a person or entity granted VAT exemption under the Tax Code, a special law or an international agreement to which the Philippines is a signatory, and by virtue of which its taxable transactions become exempt from the VAT.[61] Such *party* is also not subject to the VAT, but may be allowed a tax refund of or credit for input taxes paid, depending on its registration as a VAT or non-VAT taxpayer.

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[55] Deoferio Jr. and Mamalateo, *supra*, p. 189.

[56] *Id*., p. 43.

[57] *Id*., p. 121.

[58] De Leon, pp. 133 & 135.

[59] Deoferio Jr. and Mamalateo, *supra*, p. 118.

[60] *Id*., p. 132.

[61] *Id*., pp. 132-133.

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As mentioned earlier, the VAT is a tax on consumption, the amount of which may be shifted or passed on by the seller to the purchaser of the goods, properties or services.[62] While the *liability* is imposed on one person, the *burden* may be passed on to another. Therefore, if a special law merely exempts a party as a *seller from its direct liability* for payment of the VAT, but does not relieve the same party as a *purchaser from its indirect burden* of the VAT shifted to it by its VAT-registered suppliers, the purchase *transaction* is not exempt. Applying this principle to the case at bar, the purchase *transactions* entered into by respondent are not VAT-exempt.

Special laws may certainly exempt transactions from the VAT.[63] However, the Tax Code provides that those falling under PD 66 are not. PD 66 is the precursor of RA 7916 — the special law under which respondent was registered. The purchase *transactions* it entered into are, therefore, not VAT-exempt. These are subject to the VAT; respondent is required to register.

Its sales transactions, however, will either be zero-rated or taxed at the standard rate of 10 percent,[64] depending again on the application of the *destination principle*.[65]

If respondent enters into such sales transactions with a purchaser — usually in a foreign country — for use or consumption outside the Philippines, these shall be subject to 0 percent.[66] If entered into with a purchaser for use or consumption in the Philippines, then these shall be subject to 10 percent,[67] unless the purchaser is exempt from the indirect burden of the VAT, in which case it shall also be zero-rated.

Since the purchases of respondent are not exempt from the VAT, the rate to be applied is zero. Its exemption under both

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[62] De Leon, p. 132.

[63] §109(q) of the Tax Code.

[64] Deoferio Jr. and Mamalateo, *supra*, p. 187.

[65] *Id.*, p. 69.

[66] §106(A)(2) of the Tax Code.

[67] §106(A)(1) of the Tax Code.

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PD 66 and RA 7916 effectively subjects such transactions to a zero rate,[68] because the ecozone within which it is registered is managed and operated by the PEZA as a *separate customs territory*.[69] This means that in such zone is created the legal fiction of foreign territory. [70] Under the *cross-border principle*[71] of the VAT system being enforced by the Bureau of Internal Revenue (BIR),[72] no VAT shall be imposed to form part of the cost of goods destined for consumption outside of the territorial border of the taxing authority. If exports of goods and services from the Philippines to a foreign country are free of the VAT,[73] then the same rule holds for such exports from the national territory — except specifically declared areas — to an ecozone.

Sales made by a VAT-registered person in the customs territory to a PEZA-registered entity are considered exports to a foreign country; conversely, sales by a PEZA-registered entity to a VAT-registered person in the customs territory are deemed imports from a foreign country.[74] An ecozone — indubitably a

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[68] §106(A)(2)(c) of the Tax Code.

[69] 1st paragraph of §8, Chapter I of RA 7916.

A "customs territory" means the national territory of the Philippines outside of the proclaimed boundaries of the ecozones, except those areas specifically declared by other laws and/or presidential proclamations to have the status of special economic zones and/or free ports. §2.g, Rule 1, Part I of the "Rules and Regulations to Implement Republic Act No. 7916, otherwise known as 'The Special Economic Zone Act of 1995.'"

[70] Deoferio Jr. and Mamalateo, *supra*, p. 227.

[71] This principle is not clearly defined by any law or administrative issuance. *See Id*., p. 227.

[72] §2 of Revenue Memorandum Circular No. (RMC) 74-99 dated October 15, 1999.

This circular is an example of an agency statement of general applicability that takes the form of a revenue tax issuance "bearing on internal revenue tax rules and regulations." *Commissioner of Internal Revenue v. CA*, 329 Phil. 987, 1009, August 29, 1996, per Vitug, *J*., citing RMC 10-86. *See* §2(2), Chapter 1, Book VII of Executive Order No. (EO) 292, otherwise known as the "Administrative Code of 1987" dated July 25, 1987.

[73] §106(A)(2)(a) of the Tax Code.

[74] *See* Deoferio Jr. and Mamalateo, *supra*, p. 201.

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geographical territory of the Philippines — is, however, regarded in law as foreign soil.[75] This legal fiction is necessary to give meaningful effect to the policies of the special law creating the zone.[76] If respondent is located in an export processing zone[77] within that ecozone, sales to the export processing zone, even without being actually exported, shall in fact be viewed as *constructively exported* under EO 226. [78] Considered as export sales,[79] such purchase transactions by respondent would indeed be subject to a zero rate.[80]

Tax Exemptions
Broad and Express

Applying the special laws we have earlier discussed, respondent as an entity is exempt from internal revenue laws and regulations.

This exemption covers *both* direct and indirect taxes, stemming from the very nature of the VAT as a tax on consumption, for which the direct *liability* is imposed on one person but the indirect *burden* is passed on to another. Respondent, as an exempt entity, can neither be directly charged for the VAT on its sales nor indirectly made to bear, as added cost to such sales, the equivalent VAT on its purchases. *Ubi lex non distinguit, nec nos distinguere debemus*. Where the law does not distinguish, we ought not to distinguish.

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[75] This zone is akin to the former army bases or installations within the Philippines. *Saura Import and Export Co., Inc. v. Meer*, 88 Phil. 199, 202, February 26, 1951.

[76] Deoferio Jr. and Mamalateo, *supra*, p. 199.

[77] An "export processing zone" is a specialized industrial estate located physically and/or administratively outside customs territory, predominantly oriented to export production, and may be contained in an ecozone. §4(a) and (d), Chapter I of RA 7916.

[78] Article 23, Chapter I, Title I, Book I of EO 226. *See* §2.mm.2), Rule I, Part I of the "Rules and Regulations to Implement Republic Act No. 7916, otherwise known as 'The Special Economic Zone Act of 1995.'"

[79] Article 77(2), Book VI of EO 226.

[80] §106(A)(2)(a)(5) of the Tax Code.

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Moreover, the exemption is both express and pervasive for the following reasons:

First, RA 7916 states that "no taxes, local and national, shall be imposed on business establishments operating within the ecozone."[81] Since this law does not exclude the VAT 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.

Moreover, even though the VAT is not imposed on the entity but on the transaction, it may still be passed on and, therefore, indirectly imposed on the same entity — a patent circumvention of the law. That no VAT shall be imposed directly upon business establishments operating within the ecozone under RA 7916 also means that no VAT may be passed on and imposed indirectly. *Quando aliquid prohibetur ex directo prohibetur et per obliquum.* When anything is prohibited directly, it is also prohibited indirectly.

Second, 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 developers.[82] This similar and repeated prohibition is an unambiguous ratification of the law's intent in not imposing local or national taxes on business enterprises within the ecozone.

Third, foreign and domestic merchandise, raw materials, equipment and the like "shall not be subject to xxx internal revenue laws and regulations" under PD 66[83] — the original charter of PEZA (then EPZA) that was later amended by RA 7916.[84] No provisions in the latter law modify such exemption.

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[81] §24, Chapter III of RA 7916.

[82] §24, Chapter III of RA 7916, as amended by §4 of RA 8748 dated June 1, 1999.

[83] §17(1) of PD 66.

[84] *Estate of Salud Jimenez v. Philippine Export Processing Zone*, 349 SCRA 240, 260-261, January 16, 2001. *See* 4th paragraph, §11, Chapter II of RA 7916.

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Although this exemption puts the government at an initial disadvantage, the reduced tax collection ultimately redounds to the benefit of the national economy by enticing more business investments and creating more employment opportunities.[85]

Fourth, even the rules implementing the PEZA law clearly reiterate that merchandise — except those prohibited by law — "shall not be subject to xxx internal revenue laws and regulations xxx" [86] if brought to the ecozone's restricted area[87] for manufacturing by registered export enterprises,[88] of which respondent is one. These rules also apply to all enterprises registered with the EPZA prior to the effectivity of such rules.[89]

Fifth, export processing zone enterprises registered [90] with the Board of Investments (BOI) under EO 226 patently enjoy exemption from national internal revenue taxes on imported capital equipment reasonably needed and exclusively used for the manufacture of their products;[91] on required supplies and

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[85] *Commissioner of Customs v. Philippine Phosphate Fertilizer Corp.*, GR No. 144440, September 1, 2004, p. 7.

[86] §1, Rule VIII, Part V and Rule XV of the "Rules and Regulations to Implement Republic Act No. 7916, otherwise known as 'The Special Economic Zone Act of 1995.'"

[87] A "restricted area" is a specific area within an ecozone that is classified and/or fenced-in as an export processing zone. §2.h, Rule I, Part I of the "Rules and Regulations to Implement Republic Act No. 7916, otherwise known as 'The Special Economic Zone Act of 1995.'"

[88] A "registered export enterprise" is one that is registered with the PEZA, and that engages in manufacturing activities within the purview of the PEZA law for the exportation of its production. §2.i, Rule I, Part I of the "Rules and Regulations to Implement Republic Act No. 7916, otherwise known as 'The Special Economic Zone Act of 1995.'"

[89] §1, Rule XXV of the "Rules and Regulations to Implement Republic Act No. 7916, otherwise known as 'The Special Economic Zone Act of 1995.'" *See* §56, Chapter VI of RA 7916.

[90] Article 11, Chapter I, Book I of EO 226.

[91] Article 39(c), Title III, Book I of EO 226, expressly repealed by the 2nd paragraph of §20 of RA 7716. Consequently, enterprises registered with the BOI after December 31, 1994 will no longer enjoy the incentives provided under said article starting January 1, 1996.

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spare part for consigned equipment; [92] and on foreign and domestic merchandise, raw materials, equipment and the like — except those prohibited by law — brought into the zone for manufacturing.[93] In addition, they are given credits for the value of the national internal revenue taxes imposed on domestic capital equipment also reasonably needed and exclusively used for the manufacture of their products,[94] as well as for the value of such taxes imposed on domestic raw materials and supplies that are used in the manufacture of their export products and that form part thereof.[95]

Sixth, the exemption from local and national taxes granted under RA 7227[96] are *ipso facto* accorded to ecozones. [97] In case of doubt, conflicts with respect to such tax exemption privilege shall be resolved in favor of the ecozone.[98]

And *seventh*, the tax credits under RA 7844 — given for imported raw materials primarily used in the production of export goods,[99] and for locally produced raw materials, capital equipment and spare parts used by exporters of non-traditional products[100] — shall also be continuously enjoyed by similar exporters within the ecozone.[101] Indeed, the latter exporters are likewise entitled to such tax exemptions and credits.

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[92] Article 39(m), Title III, Book I of EO 226.

[93] Article 77(1), Book VI of EO 226.

[94] Article 39(d), Title III, Book I of EO 226, also expressly repealed by the 2nd paragraph of §20 of RA 7716. Consequently, enterprises registered with the BOI after December 31, 1994 will no longer enjoy the incentives provided under said article starting January 1, 1996.

[95] Article 39(k), Title III, Book I of EO 226.

[96] 1st paragraph of §12(c) of RA 7227.

[97] §51, Chapter VI of RA 7916.

[98] 2nd paragraph of §12(c) of RA 7227.

[99] §16(c), Article III of RA 7844.

[100] §16(e), Article III of RA 7844.

[101] 2nd paragraph of §23, Chapter III of RA 7916.

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Tax Refund as Tax Exemption

To be sure, statutes that grant tax exemptions are construed *strictissimi juris*[102] against the taxpayer[103] and liberally in favor of the taxing authority.[104]

Tax refunds are in the nature of such exemptions.[105] Accordingly, the claimants of those refunds bear the burden of proving the factual basis of their claims; [106] and of showing, by words too plain to be mistaken, that the legislature intended to exempt them.[107] In the present case, all the cited legal provisions are teeming with life with respect to the grant of tax exemptions too vivid to pass unnoticed. In addition, respondent easily meets the challenge.

Respondent, which as an entity is exempt, is different from its transactions which are not exempt. The end result, however, is that it is not subject to the VAT. The non-taxability of transactions that are otherwise taxable is merely a necessary incident to the tax exemption conferred by law upon it as an entity, not upon the transactions themselves.[108] Nonetheless, its exemption as an entity and the non-exemption of its transactions lead to the same result for the following considerations:

First, the contemporaneous construction of our tax laws by BIR authorities who are called upon to execute or administer

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[102] *Commissioner of Internal Revenue v. General Foods (Phils.), Inc.*, 401 SCRA 545, 550, April 24, 2003.

[103] *Commissioner of Internal Revenue v. Solidbank Corp.*, 416 SCRA 436, 461, November 25, 2003.

[104] Agpalo, *Statutory Construction* (2nd ed., 1990), p. 217.

[105] *BPI Leasing Corp. v. CA*, 416 SCRA 4, 14, November 18, 2003.

[106] *Paseo Realty & Development Corp. v. CA*, GR No. 119286, October 13, 2004, p. 14.

[107] *Surigao Consolidated Mining Co., Inc. v. Collector of Internal Revenue*, 119 Phil. 33, 37, December 26, 1963.

[108] *Deoferio Jr. and Mamalateo, supra*, p. 155.

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such laws[109] will have to be adopted. Their prior tax issuances have held inconsistent positions brought about by their probable failure to comprehend and fully appreciate the nature of the VAT as a tax on consumption and the application of the *destination principle*.[110] Revenue Memorandum Circular No. (RMC) 74-99, however, now clearly and correctly provides that any VAT-registered supplier's sale of goods, property or services from the customs territory to any registered enterprise operating in the ecozone — regardless of the class or type of the latter's PEZA registration — is legally entitled to a zero rate.[111]

Second, the policies of the law should prevail. *Ratio legis est anima*. The reason for the law is its very soul.

In PD 66, the urgent creation of the EPZA which preceded the PEZA, as well as the establishment of export processing zones, seeks "to encourage and promote foreign commerce as a means of xxx strengthening our export trade and foreign exchange position, of hastening industrialization, of reducing domestic unemployment, and of accelerating the development of the country."[112]

RA 7916, as amended by RA 8748, declared that by creating the PEZA and integrating the special economic zones, "the government shall actively encourage, promote, induce and accelerate a sound and balanced industrial, economic and social development of the country xxx through the establishment, among others, of special economic zones xxx that shall effectively attract legitimate and productive foreign investments."[113]

Under EO 226, the "State shall encourage xxx foreign investments in industry xxx which shall xxx meet the tests of international competitiveness[,] accelerate development of less developed regions of the country[,] and result in increased volume

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[109] Agpalo, *supra*, pp. 82-83.

[110] Deoferio Jr. and Mamalateo, *supra*, p. 218.

[111] §3(3) of Revenue Memorandum Circular No. (RMC) 74-99.

[112] §§1 and 2 of PD 66.

[113] 2nd paragraph of §2, Chapter I of RA 7916.

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and value of exports for the economy." [114] Fiscal incentives that are cost-efficient and simple to administer shall be devised and extended to significant projects "to compensate for market imperfections, to reward performance contributing to economic development,"[115] and "to stimulate the establishment and assist initial operations of the enterprise."[116]

Wisely accorded to ecozones created under RA 7916[117] was the government's policy — spelled out earlier in RA 7227 — of converting into alternative productive uses[118] the former military reservations and their extensions,[119] as well as of providing them incentives[120] to enhance the benefits that would be derived from them[121] in promoting economic and social development.[122]

Finally, under RA 7844, the State declares the need "to evolve export development into a national effort"[123] in order to win international markets. By providing many export and tax incentives,[124] the State is able to drive home the point that exporting is indeed "the key to national survival and the means through which the economic goals of increased employment and enhanced incomes can most expeditiously be achieved."[125]

The Tax Code itself seeks to "promote sustainable economic growth xxx; xxx increase economic activity; and xxx create a

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[114] Article 2.1, Chapter I of EO 226.

[115] Article 2.3, Chapter I of EO 226.

[116] Article 2.8, Chapter I of EO 226.

[117] §51, Chapter VI of RA 7916.

[118] *Tiu v. CA*, 361 Phil. 229, 242, January 20, 1999.

[119] 1st paragraph of §2, RA 7227.

[120] §§12 and 15 of RA 7227.

[121] *John Hay Peoples Alternative Coalition v. Lim*, 414 SCRA 356, 369, October 24, 2003.

[122] 2nd paragraph of §2, RA 7227.

[123] 1st paragraph of §2, Article I of RA 7844.

[124] §§4(c) of Article I, 16, and 17 of RA 7844.

[125] 2nd paragraph of §2, Article I of RA 7844.

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robust environment for business to enable firms to compete better in the regional as well as the global market."[126] After all, international competitiveness requires economic and tax incentives to lower the cost of goods produced for export. State actions that affect global competition need to be specific and selective in the pricing of particular goods or services.[127]

All these statutory policies are congruent to the constitutional mandates of providing incentives to needed investments, [128] as well as of promoting the preferential use of domestic materials and locally produced goods and adopting measures to help make these competitive.[129] Tax credits for domestic inputs strengthen backward linkages. Rightly so, "the rule of law and the existence of credible and efficient public institutions are essential prerequisites for sustainable economic development."[130]

VAT Registration, Not Application for Effective Zero Rating, Indispensable to VAT Refund

Registration is an indispensable requirement under our VAT law.[131] Petitioner alleges that respondent did register for VAT purposes with the appropriate Revenue District Office. However, it is now too late in the day for petitioner to challenge the VAT-registered status of respondent, given the latter's prior representation before the lower courts and the mode of appeal taken by petitioner before this Court.

The PEZA law, which carried over the provisions of the EPZA law, is clear in exempting from internal revenue laws

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[126] §2 of the Tax Code, as amended by RA 8761 effective January 1, 2000; and by RA 9010, the effectivity of which has been retroacted to January 1, 2001.

[127] American Society of International Law Proceedings, "*Indigenous People and the Global Trade Regime*," 96 Asilproc 279, 281, March 16, 2002.

[128] §20 of Article II of the 1987 Constitution.

[129] 2nd paragraph of §1 and §12 of Article XII of the 1987 Constitution.

[130] Schwab, extract from the Preface of the *Global Competitiveness Report* 2003-2004, www.weforum.org, last visited January 27, 2005, 9:05am PST.

[131] §236 of the Tax Code.

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and regulations the equipment — including capital goods — that registered enterprises will use, directly or indirectly, in manufacturing.[132] EO 226 even reiterates this privilege among the incentives it gives to such enterprises.[133] Petitioner merely asserts that by virtue of the PEZA registration alone of respondent, the latter is not subject to the VAT. Consequently, the capital goods and services respondent has purchased are not considered used in the VAT business, and no VAT refund or credit is due.[134] This is a *non sequitur*. By the VAT's very nature as a tax on consumption, the capital goods and services respondent has purchased are subject to the VAT, although at zero rate. Registration does not determine taxability under the VAT law.

Moreover, the facts have already been determined by the lower courts. Having failed to present evidence to support its contentions against the *income tax holiday* privilege of respondent,[135] petitioner is deemed to have conceded. It is a cardinal rule that "issues and arguments not adequately and seriously brought below cannot be raised for the first time on appeal."[136] This is a "matter of procedure"[137] and a "question of fairness."[138] Failure to assert "within a reasonable time warrants a presumption that the party entitled to assert it either has abandoned or declined to assert it."[139]

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[132] §17(1) of PD 66 and §56, Chapter VI of RA 7916.

[133] Article 77(1), Book VI of EO 226.

[134] Petitioner's Memorandum, p. 9; *rollo*, p. 103.

[135] CA Decision, p. 7; *rollo*, p. 27; and CTA Decision, p. 5, *rollo*, p. 35.

[136] *Magnolia Dairy Products Corp. v. NLRC*, 322 Phil. 508, 517, per Francisco, *J*.

[137] *Commissioner of Internal Revenue v. Procter & Gamble Philippine Manufacturing Corp*., 204 SCRA 377, 383, December 2, 1991, per Feliciano, *J*.

[138] *Ibid*. See *Advertising Associates, Inc. v. Collector of Internal Revenue*, 97 Phil. 636, 641, September 30, 1955.

[139] *Atlas Consolidated Mining & Development Corp. v. Commissioner of Internal Revenue*, 102 SCRA 246, 259, January 27, 1981, per De Castro, *J*.

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The BIR regulations additionally requiring an approved prior application for effective zero rating[140] cannot prevail over the clear VAT nature of respondent's transactions. The scope of such regulations is not "within the statutory authority xxx granted by the legislature.[141]

First, a mere administrative issuance, like a BIR regulation, cannot amend the law; the former cannot purport to do any more than interpret the latter. [142] The courts will not countenance one that overrides the statute it seeks to apply and implement.[143]

Other than the general registration of a taxpayer the VAT status of which is aptly determined, no provision under our VAT law requires an additional application to be made for such taxpayer's transactions to be considered effectively zero-rated. An effectively zero-rated transaction does not and cannot become exempt simply because an application therefor was not made or, if made, was denied. To allow the additional requirement is to give unfettered discretion to those officials or agents who, without fluid consideration, are bent on denying a valid application. Moreover, the State can never be estopped by the omissions, mistakes or errors of its officials or agents.[144]

Second, grantia argumenti that such an application is required by law, there is still the presumption of regularity in the performance of official duty.[145] Respondent's registration carries with it the presumption that, in the absence of contradictory evidence, an application for effective zero rating was also filed and approval thereof given. Besides, it is also presumed that the law has been obeyed[146] by both the administrative officials and the applicant.

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[140] §4.107-1(d) of RR 7-95.

[141] *Commissioner of Internal Revenue v. Solidbank Corp., supra*, p. 448, per Panganiban, *J.*

[142] Vitug and Acosta, *supra*, p. 56.

[143] *Id.*, p. 57.

[144] *Spouses Morandarte v. CA*, GR No. 123586, August 12, 2004, p. 15.

[145] §3(m) of Rule 131 of the Rules of Court.

[146] §3(ff) of Rule 131 of the Rules of Court.

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Third, even though such an application was not made, all the special laws we have tackled exempt respondent not only from internal revenue *laws* but also from the *regulations* issued pursuant thereto. Leniency in the implementation of the VAT in ecozones is an imperative, precisely to spur economic growth in the country and attain global competitiveness as envisioned in those laws.

A VAT-registered status, as well as compliance with the invoicing requirements,[147] is sufficient for the effective zero rating of the transactions of a taxpayer. The nature of its business and transactions can easily be perused from, as already clearly indicated in, its VAT registration papers and photocopied documents attached thereto. Hence, its transactions cannot be exempted by its mere failure to apply for their effective zero rating. Otherwise, their VAT exemption would be determined, not by their nature, but by the taxpayer's negligence — a result not at all contemplated. Administrative convenience cannot thwart legislative mandate.

Tax Refund or Credit in Order

Having determined that respondent's purchase transactions are subject to a zero VAT rate, the tax refund or credit is in order.

As correctly held by both the CA and the Tax Court, respondent had chosen the fiscal incentives in EO 226 over those in RA 7916 and PD 66. It opted for the *income tax holiday regime* instead of the 5 percent *preferential tax regime.*

The latter scheme is not a perfunctory aftermath of a simple registration under the PEZA law,[148] for EO 226[149] also has provisions to contend with. These two regimes are in fact incompatible and cannot be availed of simultaneously by the

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[147] §113(A) of the Tax Code.

[148] §24, Chapter III of RA 7916, as amended by §4 of RA 8748.

[149] 1st paragraph, §23, Chapter III of RA 7916.

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same entity. While EO 226 merely exempts it from income taxes, the PEZA law exempts it from all taxes.

Therefore, respondent can be considered exempt, not from the VAT, but only from the payment of income tax for a certain number of years, depending on its registration as a pioneer or a non-pioneer enterprise. Besides, the remittance of the aforesaid 5 percent of gross income earned in lieu of local and national taxes imposable upon business establishments within the ecozone cannot outrightly determine a VAT exemption. Being subject to VAT, payments erroneously collected thereon may then be refunded or credited.

Even if it is argued that respondent is subject to the 5 percent *preferential tax regime* in RA 7916, Section 24 thereof does not preclude the VAT. One can, therefore, counterargue that such provision merely exempts respondent from taxes imposed on business. To repeat, the VAT is a tax imposed on consumption, not on business. Although respondent as an entity is exempt, the transactions it enters into are not necessarily so. The VAT payments made in excess of the zero rate that is imposable may certainly be refunded or credited.

Compliance with All Requisites for VAT Refund or Credit

As further enunciated by the Tax Court, respondent complied with all the requisites for claiming a VAT refund or credit.[150]

First, respondent is a VAT-registered entity. This fact alone distinguishes the present case from *Contex*, in which this Court held that the petitioner therein was registered as a non-VAT taxpayer.[151] Hence, for being merely VAT-exempt, the petitioner in that case cannot claim any VAT refund or credit.

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[150] As a matter of principle, it is inadvisable to set aside such a conclusion, because by the very nature of its functions and sans abuse or improvident exercise of its authority, the Tax Court is "dedicated exclusively to the study and consideration of tax problems and has necessarily developed an expertise on the subject xxx" *Paseo Realty & Development Corp. v. CA; supra*, per Tinga, *J.*, p. 8.

[151] *Contex Corp. v. Hon. Commissioner of Internal Revenue*, GR No. 151135, July 2, 2004, p. 11.

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Second, the input taxes paid on the capital goods of respondent are duly supported by VAT invoices and have not been offset against any output taxes. Although enterprises registered with the BOI after December 31, 1994 would no longer enjoy the tax credit incentives on domestic capital equipment — as provided for under Article 39(d), Title III, Book I of EO 226[152] — starting January 1, 1996, respondent would still have the same benefit under a general and express exemption contained in both Article 77(1), Book VI of EO 226; and Section 12, paragraph 2 (c) of RA 7227, extended to the ecozones by RA 7916.

There was a very clear intent on the part of our legislators, not only to exempt investors in ecozones from national and local taxes, but also to grant them tax credits. This fact was revealed by the sponsorship speeches in Congress during the second reading of House Bill No. 14295, which later became RA 7916, as shown below:

"MR. RECTO. xxx Some of the incentives that this bill provides are exemption from national and local taxes; . . . tax credit for locally-sourced inputs xxx"

xxx xxx xxx

"MR. DEL MAR. xxx To advance its cause in encouraging investments and creating an environment conducive for investors, the bill offers incentives such as the exemption from local and national taxes, xxx tax credits for locally sourced inputs xxx"[153]

And *third*, no question as to either the filing of such claims within the prescriptive period or the validity of the VAT returns has been raised. Even if such a question were raised, the tax exemption under all the special laws cited above is broad enough to cover even the enforcement of internal revenue laws, including prescription.[154]

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[152] This provision has been expressly repealed by the 2nd paragraph of §20 of RA 7716. See note 94.

[153] Legislative Archives, Committee Report No. 01027, House of Representatives, December 14, 1994, pp. 00132 & 00141.

[154] *Commissioner of Customs v. Philippine Phosphate Fertilizer Corp.; supra*, pp. 9-10.

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Summary

To summarize, special laws expressly grant preferential tax treatment to business establishments registered and operating within an ecozone, which by law is considered as a *separate customs territory.* As such, respondent is exempt from all internal revenue taxes, including the VAT, and regulations pertaining thereto. It has opted for the *income tax holiday regime*, instead of the 5 percent *preferential tax regime*. As a matter of law and procedure, its registration status entitling it to such tax holiday can no longer be questioned. Its sales transactions intended for export may not be exempt, but like its purchase transactions, they are zero-rated. No prior application for the effective zero rating of its transactions is necessary. Being VAT-registered and having satisfactorily complied with all the requisites for claiming a tax refund of or credit for the input VAT paid on capital goods purchased, respondent is entitled to such VAT refund or credit.

WHEREFORE, the Petition is *DENIED* and the Decision *AFFIRMED*. No pronouncement as to costs.

SO ORDERED.

Sandoval-Gutierrez, Corona, Carpio Morales, and *Garcia, JJ.,* concur.