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And as aptly found by respondent Sandiganbayan, "*the fact that (the) immediate superiors of the accused (petitioner herein) have acquiesced to the practice of giving out cash advances for convenience did not legalize the disbursements.*"[29] (Italics supplied)

WHEREFORE, the petition is *DENIED* for lack of merit.

Costs against petitioner.

SO ORDERED.

Panganiban (Chairman), Sandoval-Gutierrez, and *Garcia, JJ.,* concur.

Corona, J., on leave.

SECOND DIVISION

[G.R. No. 150154. August 9, 2005]

COMMISSIONER OF INTERNAL REVENUE, *petitioner, vs.* **TOSHIBA INFORMATION EQUIPMENT (PHILS.), INC.,** *respondent.*

SYLLABUS

1. TAXATION; VALUE ADDED TAX; EXEMPT TRANSACTIONS; TRANSACTIONS EXEMPT UNDER SPECIAL LAWS; VAT-EXEMPT TRANSACTIONS DISTINGUISHED FROM VAT-EXEMPT ENTITIES.— It would seem that petitioner CIR failed to differentiate between VAT-exempt transactions from VAT-exempt entities. In the case of *Commissioner of Internal Revenue v. Seagate Technology (Philippines)*, this Court already made such distinction – An *exempt transaction*, on the one hand, involves goods or services which, by their nature, are specifically listed in and expressly

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[29] *Id.* at 771.

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exempted from the VAT under the Tax Code, without regard to the tax status – VAT-exempt or not – of the party to the transaction… 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 VAT… Section 103(q) of the Tax Code of 1977, as amended, relied upon by petitioner CIR, relates to VAT-exempt transactions. These are transactions exempted from VAT by special laws or international agreements to which the Philippines is a signatory. Since such transactions are not subject to VAT, the sellers cannot pass on any output VAT to the purchasers of goods, properties, or services, and they may not claim tax credit/refund of the input VAT they had paid thereon.

2. ID.; ID.; ID.; ID.; THE EXCEPTION OF PRESIDENTIAL DECREE NO. 66, OR THE ACT CREATING THE "EXPORT PROCESSING ZONE AUTHORITY (EPZA)" FROM SECTION 103 (q) OF THE TAX CODE OF 1977, AS AMENDED, EXTENDS TO REPUBLIC ACT NO. 7916 OR "THE SPECIAL ECONOMIC ZONE ACT OF 1995," AS AMENDED.— Section 103(q) of the Tax Code of 1977, as amended, cannot apply to transactions of respondent Toshiba because although the said section recognizes that transactions covered by special laws may be exempt from VAT, the very same section provides that those falling under Presidential Decree No. 66 are not. Presidential Decree No. 66, creating the Export Processing Zone Authority (EPZA), is the precursor of Rep. Act No. 7916, as amended, under which the EPZA evolved into the PEZA. Consequently, the exception of Presidential Decree No. 66 from Section 103(q) of the Tax Code of 1977, as amended, extends likewise to Rep. Act No. 7916, as amended.

3. ID.; ID.; ID.; ID.; THE PHILIPPINE ECONOMIC-ZONE AUTHORITY (EPZA) OR PEZA-REGISTERED ENTERPRISES, WHICH WOULD NECESSARILY BE LOCATED WITHIN ECOZONES, ARE VAT-EXEMPT ENTITIES BECAUSE SECTION 8 OF THE SAME STATUTE ESTABLISHES THE FICTION THAT ECOZONES ARE FOREIGN TERRITORY.— This Court agrees, however, that PEZA-registered enterprises, which would necessarily be located within ECOZONES, are VAT-exempt entities, not because of Section 24 of Rep. Act No. 7916, as

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amended, which imposes the five percent (5%) preferential tax rate on gross income of PEZA-registered enterprises, in lieu of all taxes; but, rather, because of Section 8 of the same statute which establishes the fiction that ECOZONES are foreign territory. It is important to note herein that respondent Toshiba is located within an ECOZONE. An ECOZONE or a Special Economic Zone has been described as – . . . [S]elected areas with highly developed or which have the potential to be developed into agro-industrial, industrial, tourist, recreational, commercial, banking, investment and financial centers whose metes and bounds are fixed or delimited by Presidential Proclamations. An ECOZONE may contain any or all of the following: industrial estates (IEs), export processing zones (EPZs), free trade zones and tourist/recreational centers. The national territory of the Philippines outside of the proclaimed borders of the ECOZONE shall be referred to as the Customs Territory.

4. ID.; ID.; ID.; ID.; NO OUTPUT VAT MAY BE PASSED ON TO AN ECOZONE ENTERPRISE SINCE IT IS A VAT-EXEMPT ENTITY.— The Philippine VAT system adheres to the Cross Border Doctrine, according to which, 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. Hence, actual export of goods and services from the Philippines to a foreign country must be free of VAT; while, those destined for use or consumption within the Philippines shall be imposed with ten percent (10%) VAT. Applying said doctrine to the sale of goods, properties, and services to and from the ECOZONES, the BIR issued Revenue Memorandum Circular (RMC) No. 74-99, on 15 October 1999. Indubitably, no output VAT may be passed on to an ECOZONE enterprise since it is a VAT-exempt entity.

5. ID.; ID.; ID.; ID.; EVEN CONCEDING THAT RESPONDENT COMPANY, AS A PEZA REGISTERED ENTERPRISE, IS A VAT-EXEMPT ENTITY THAT COULD NOT HAVE ENGAGED IN VAT TAXABLE BUSINESS, THE COURT STILL BELIEVES, GIVEN THE CIRCUMSTANCES OF THE PRESENT CASE, THAT IT IS ENTITLED TO A CREDIT/ REFUND OF ITS INPUT VAT.— The VAT treatment of sales to it, however, varies depending on whether the supplier from the Customs Territory is VAT-registered or not. Sales of goods, properties and services by a VAT-registered supplier from the

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Customs Territory to an ECOZONE enterprise shall be treated as export sales. If such sales are made by a VAT-registered supplier, they shall be subject to VAT at zero percent (0%). In zero-rated transactions, the VAT-registered supplier shall not pass on any output VAT to the ECOZONE enterprise, and at the same time, shall be entitled to claim tax credit/refund of its input VAT attributable to such sales. Zero-rating of export sales primarily intends to benefit the exporter (*i.e.*, the supplier from the Customs Territory), who is directly and legally liable for the VAT, making it internationally competitive by allowing it to credit/refund the input VAT attributable to its export sales. Meanwhile, sales to an ECOZONE enterprise made by a non-VAT or unregistered supplier would only be exempt from VAT and the supplier shall not be able to claim credit/refund of its input VAT. Even conceding, however, that respondent Toshiba, as a PEZA-registered enterprise, is a VAT-exempt entity that could not have engaged in a VAT-taxable business, this Court still believes, given the particular circumstances of the present case, that it is entitled to a credit/refund of its input VAT.

6. ID.; ID.; ID.; ID.; RESPONDENT COMPANY BASED ITS CLAIM FOR TAX CREDIT OR REFUND ON SECTION 4.106-1(b) OF RR NO.7-95, AS AMENDED, A REGULATION ALLOWING A VAT-REGISTERED PERSON TO APPLY FOR TAX CREDIT/REFUND OF INPUT VAT ON ITS CAPITAL GOODS.— This Court wishes to point out that petitioner CIR is working on the erroneous premise that respondent Toshiba is claiming tax credit or refund of input VAT based on Section 4.100-2, in relation to Section 4.106-1(a), of RR No. 7-95, as amended, which allows the tax credit/refund of input VAT on zero-rated sales of goods, properties or services. Instead, respondent Toshiba is basing its claim for tax credit or refund on Sec. 4.106-1(b) of the same regulations, which allows a VAT-registered person to apply for tax credit/refund of the input VAT on its capital goods. While in the former, the seller of the goods, properties or services is the one entitled to the tax credit/refund; in the latter, it is the purchaser of the capital goods.

7. ID.; ID.; ID.; ID.; FISCAL INCENTIVES FOR PEZA-REGISTERED ENTERPRISES UNDER THE OLD VAT RULE.— This old rule clearly did not take into consideration the Cross Border Doctrine essential to the VAT system or the

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fiction of the ECOZONE as a foreign territory. It relied totally on the choice of fiscal incentives of the PEZA-registered enterprise. Again, for emphasis, the old VAT rule for PEZA-registered enterprises was based on their choice of fiscal incentives: (1) If the PEZA-registered enterprise chose the five percent (5%) preferential tax on its gross income, in lieu of all taxes, as provided by Rep. Act No. 7916, as amended, then it would be VAT-exempt; (2) If the PEZA-registered enterprise availed of the income tax holiday under Exec. Order No. 226, as amended, it shall be subject to VAT at ten percent (10%). Such distinction was abolished by RMC No. 74-99, which categorically declared that all sales of goods, properties, and services made by a VAT-registered supplier from the Customs Territory to an ECOZONE enterprise shall be subject to VAT, at zero percent (0%) rate, regardless of the latter's type or class of PEZA registration; and, thus, affirming the nature of a PEZA-registered or an ECOZONE enterprise as a VAT-exempt entity.

8. ID.; ID.; ID.; ID.; SINCE RESPONDENT COMPANY OPTED TO AVAIL ITSELF OF THE INCOME TAX HOLIDAY UNDER EXEC. ORDER NO. 226, AS AMENDED, THEN IT IS DEEMED SUBJECT TO THE TEN PERCENT (10%) VAT; IT WAS VERY LIKELY THEREFORE THAT SUPPLIERS FROM THE CUSTOMS TERRITORY HAD PASSED ON OUTPUT VAT TO RESPONDENT COMPANY, AND THE LATTER, THUS, INCURRED INPUT VAT.— The sale of capital goods by suppliers from the Customs Territory to respondent Toshiba in the present Petition took place during the first and second quarters of 1996, way before the issuance of RMC No. 74-99, and when the old rule was accepted and implemented by no less than the BIR itself. Since respondent Toshiba opted to avail itself of the income tax holiday under Exec. Order No. 226, as amended, then it was deemed subject to the ten percent (10%) VAT. It was very likely therefore that suppliers from the Customs Territory had passed on output VAT to respondent Toshiba, and the latter, thus, incurred input VAT. It bears emphasis that the CTA, with the help of SGV & Co., the independent accountant it commissioned to make a report, already thoroughly reviewed the evidence submitted by respondent Toshiba consisting of receipts, invoices, and vouchers, from its suppliers from the Customs Territory. Accordingly, this Court gives due respect to and adopts herein the CTA's findings that the suppliers of capital goods from the Customs Territory did

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pass on output VAT to respondent Toshiba and the amount of input VAT which respondent Toshiba could claim as credit/refund.

9. REMEDIAL LAW; EVIDENCE; FINDINGS OF FACT OF THE COURT OF TAX APPEALS ARE RESPECTED AND ADOPTED BY THE COURT.— Finally, petitioner CIR, in a last desperate attempt to block respondent Toshiba's claim for tax credit/refund, challenges the allegation of said respondent that it availed of the income tax holiday under Exec. Order No. 226, as amended, rather than the five percent (5%) preferential tax rate under Rep. Act No. 7916, as amended. Undoubtedly, this is a factual matter that should have been raised and threshed out in the lower courts. Giving it credence would belie petitioner CIR's assertion that it is raising only issues of law in its Petition that may be resolved without need for reception of additional evidences. Once more, this Court respects and adopts the finding of the CTA, affirmed by the Court of Appeals, that respondent Toshiba had indeed availed of the income tax holiday under Exec. Order No. 226, as amended.

APPEARANCES OF COUNSEL

Litigation Division (BIR) for petitioner.
Avisado Agan Montenegro & Associates for respondent.

D E C I S I O N

CHICO-NAZARIO, *J.*:

In this Petition for Review under Rule 45 of the Rules of Court, petitioner Commissioner of Internal Revenue (CIR) prays for the reversal of the decision of the Court of Appeals in CA-G.R. SP No. 59106,[1] affirming the order of the Court of Tax Appeals (CTA) in CTA Case No. 5593,[2] which ordered said

[1] Penned by Associate Justice Wenceslao I. Agnir with Associate Justices Salvador J. Valdez, Jr. and Mariano C. Del Castillo, concurring; *Rollo*, pp. 26-36.

[2] Penned by Associate Judge Amancio Q. Saga with Presiding Judge Ernesto D. Acosta and Associate Judge Ramon O. De Veyra, concurring; *Id.*, pp. 37-48.

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petitioner CIR to refund or, in the alternative, to issue a tax credit certificate to respondent Toshiba Information Equipment (Phils.), Inc. (Toshiba), in the amount of ₱16,188,045.44, representing unutilized input value-added tax (VAT) payments for the first and second quarters of 1996.

There is hardly any dispute as to the facts giving rise to the present Petition.

Respondent Toshiba was organized and established as a domestic corporation, duly-registered with the Securities and Exchange Commission on 07 July 1995,[3] with the primary purpose of engaging in the business of manufacturing and exporting of electrical and mechanical machinery, equipment, systems, accessories, parts, components, materials and goods of all kinds, including, without limitation, to those relating to office automation and information technology, and all types of computer hardware and software, such as HDD, CD-ROM and personal computer printed circuit boards.[4]

On 27 September 1995, respondent Toshiba also registered with the Philippine Economic Zone Authority (PEZA) as an ECOZONE Export Enterprise, with principal office in Laguna Technopark, Biñan, Laguna.[5] Finally, on 29 December 1995, it registered with the Bureau of Internal Revenue (BIR) as a VAT taxpayer and a withholding agent.[6]

Respondent Toshiba filed its VAT returns for the first and second quarters of taxable year 1996, reporting input VAT in the amount of ₱13,118,542.00[7] and ₱5,128,761.94,[8] respectively,

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[3] Securities and Exchange Commission (SEC) Certificate of Registration No. AS095-006536, CTA Records, p. 75.

[4] Articles of Incorporation, *Id*., p. 76; Petition for Review, *Id*., pp. 1-2.

[5] Philippine Economic Zone Authority (PEZA) Certificate of Registration No. 95-99, *Id*., p. 88.

[6] Bureau of Internal Revenue (BIR) Certificate of Registration No. 95-570-001544, *Id*., p. 99.

[7] *Id*., p. 90.

[8] *Id*., p. 91.

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or a total of ₱18,247,303.94. It alleged that the said input VAT was from its purchases of capital goods and services which remained unutilized since it had not yet engaged in any business activity or transaction for which it may be liable for any output VAT.[9] Consequently, on 27 March 1998, respondent Toshiba filed with the One-Stop Shop Inter-Agency Tax Credit and Duty Drawback Center of the Department of Finance (DOF) applications for tax credit/refund of its unutilized input VAT for 01 January to 31 March 1996 in the amount of ₱14,176,601.28,[10] and for 01 April to 30 June 1996 in the amount of ₱5,161,820.79,[11] for a total of ₱19,338,422.07. To toll the running of the two-year prescriptive period for judicially claiming a tax credit/refund, respondent Toshiba, on 31 March 1998, filed with the CTA a Petition for Review. It would subsequently file an Amended Petition for Review on 10 November 1998 so as to conform to the evidence presented before the CTA during the hearings.

In his Answer to the Amended Petition for Review before the CTA, petitioner CIR raised several Special and Affirmative Defenses, to wit —

5. Assuming without admitting that petitioner filed a claim for refund/tax credit, the same is subject to investigation by the Bureau of Internal Revenue.

6. Taxes are presumed to have been collected in accordance with law. Hence, petitioner must prove that the taxes sought to be refunded were erroneously or illegally collected.

7. Petitioner must prove the allegations supporting its entitlement to a refund.

8. Petitioner must show that it has complied with the provisions of Sections 204(c) and 229 of the 1997 Tax Code on the filing of a written claim for refund within two (2) years from the date of payment of the tax.

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[9] Amended Petition for Review, *Id*., pp. 42-43.

[10] *Id*., pp. 98-99.

[11] *Id*., pp. 100-101.

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9. Claims for refund of taxes are construed strictly against claimants, the same being in the nature of an exemption from taxation.[12]

After evaluating the evidence submitted by respondent Toshiba,[13] the CTA, in its Decision dated 10 March 2000, ordered petitioner CIR to refund, or in the alternative, to issue a tax credit certificate to respondent Toshiba in the amount of ₱16,188,045.44.[14]

In a Resolution, dated 24 May 2000, the CTA denied petitioner CIR's Motion for Reconsideration for lack of merit.[15]

The Court of Appeals, in its Decision dated 27 September 2001, dismissed petitioner CIR's Petition for Review and affirmed the CTA Decision dated 10 March 2000.

Comes now petitioner CIR before this Court assailing the above-mentioned Decision of the Court of Appeals based on the following grounds —

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[12] *Id*., p. 58.

[13] During the hearing before the CTA on 27 May 1999, counsel for petitioner Commissioner manifested that there was no report of investigation from the One-Stop Shop of the DOF and moved for the submission of the case for decision without presenting any evidence, which was granted by the CTA, *Id*., p. 124.

[14] The CTA computed the amount as follows —

	Per Claim	Per Return	Should be Subject of the Claim
1st Quarter 1996	₱14,176,601.28	₱13,118,542.00	₱13,118,542.00
2nd Quarter 1996	5,161,820.79	5,128,761.94	5,128,761.94
Sub-Total	₱19,338,422.07	₱18,247,303.94	₱18,247,303.94
Less: Disallowances by CTA's Findings			₱ 2,059,258.50
Total Amount Refundable			₱16,188,045.44

Supra, note 2, pp. 42-43, 45-48.

[15] Signed by Presiding Judge Ernesto D. Acosta and Associate Judge Amancio Q. Saga, with Associate Judge Ramon O. De Veyra on leave, CTA Records, pp. 186-187.

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1. The Court of Appeals erred in holding that petitioner's failure to raise in the Tax Court the arguments relied upon by him in the petition, is fatal to his cause.

2. The Court of Appeals erred in not holding that respondent being registered with the Philippine Economic Zone Authority (PEZA) as an Ecozone Export Enterprise, its business is not subject to VAT pursuant to Section 24 of Republic Act No. 7916 in relation to Section 103 (now 109) of the Tax Code.

3. The Court of Appeals erred in not holding that since respondent's business is not subject to VAT, the capital goods and services it purchased are considered not used in VAT taxable business, and, therefore, it is not entitled to refund of input taxes on such capital goods pursuant to Section 4.106-1 of Revenue Regulations No. 7-95 and of input taxes on services pursuant to Section 4.103-1 of said Regulations.

4. The Court of Appeals erred in holding that respondent is entitled to a refund or tax credit of input taxes it paid on zero-rated transactions.[16]

Ultimately, however, the issue still to be resolved herein shall be whether respondent Toshiba is entitled to the tax credit/refund of its input VAT on its purchases of capital goods and services, to which this Court answers in the affirmative.

I

An ECOZONE enterprise is a VAT-exempt entity. Sales of goods, properties, and services by persons from the Customs Territory to ECOZONE enterprises shall be subject to VAT at zero percent (0%).

Respondent Toshiba bases its claim for tax credit/refund on Section 106(b) of the Tax Code of 1977, as amended, which reads:

SEC. 106. *Refunds or tax credits of creditable input tax.* —

xxx xxx xxx

(b) *Capital goods.* — A VAT-registered person may apply for the issuance of a tax credit certificate or refund of input taxes paid on

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[16] *Rollo*, pp. 12-13.

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capital goods imported or locally purchased, to the extent that such input taxes have not been applied against output taxes. The application may be made only within two (2) years after the close of the taxable quarter when the importation or purchase was made.[17]

Petitioner CIR, on the other hand, opposes such claim on account of Section 4.106-1(b) of Revenue Regulations (RR) No. 7-95, otherwise known as the VAT Regulations, as amended, which provides as follows —

Sec. 4.106-1. *Refunds or tax credits of input tax.* —

xxx xxx xxx

(b) *Capital Goods.* — Only a VAT-registered person may apply for issuance of a tax credit certificate or refund of input taxes paid on capital goods imported or locally purchased. The refund shall be allowed to the extent that such input taxes have not been applied against output taxes. The application should be made within two (2) years after the close of the taxable quarter when the importation or purchase was made.

Refund of input taxes on capital goods shall be allowed *only to the extent that such capital goods are used in VAT taxable business.* If it is also used in exempt operations, the input tax refundable shall only be the ratable portion corresponding to the taxable operations.

"*Capital goods or properties*" refer to goods or properties with estimated useful life greater than one year and which are treated as depreciable assets under Section 29(f), used directly or indirectly in the production or sale of taxable goods or services. (Italics ours.)

Petitioner CIR argues that although respondent Toshiba may be a VAT-registered taxpayer, it is not engaged in a VAT-taxable business. According to petitioner CIR, respondent Toshiba is actually VAT-exempt, invoking the following provision of the Tax Code of 1977, as amended —

SEC. 103. *Exempt transactions.* — The following shall be exempt from value-added tax.

xxx xxx xxx

[17] Now Section 112(B) under the Tax Code of 1997.

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(q) Transactions which are exempt under special laws, except those granted under Presidential Decree No. 66, 529, 972, 1491, and 1590, and non-electric cooperatives under Republic Act No. 6938, or international agreements to which the Philippines is a signatory.[18]

Since respondent Toshiba is a PEZA-registered enterprise, it is subject to the five percent (5%) preferential tax rate imposed under Chapter III, Section 24 of Republic Act No. 7916, otherwise known as The Special Economic Zone Act of 1995, as amended. According to the said section, "[e]xcept for real property taxes on land owned by developers, no taxes, local and national, shall be imposed on business establishments operating within the ECOZONE. In lieu thereof, five percent (5%) of the gross income earned by all business enterprises within the ECOZONE shall be paid . . ." The five percent (5%) preferential tax rate imposed on the gross income of a PEZA-registered enterprise shall be in lieu of all national taxes, including VAT. Thus, petitioner CIR contends that respondent Toshiba is VAT-exempt by virtue of a special law, Rep. Act No. 7916, as amended.

It would seem that petitioner CIR failed to differentiate between VAT-exempt transactions from VAT-exempt entities. In the case of *Commissioner of Internal Revenue v. Seagate Technology (Philippines)*,[19] this Court already made such distinction —

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 . . .

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 VAT . . .

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[18] Now Section 109(q) of the Tax Code of 1997, as amended, which reads, "Transactions which are exempt under international agreements to which the Philippines is a signatory or under special laws, except those under Presidential Decree Nos. 66, 529 and 1590."

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

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Section 103(q) of the Tax Code of 1977, as amended, relied upon by petitioner CIR, relates to VAT-exempt transactions. These are transactions exempted from VAT by special laws or international agreements to which the Philippines is a signatory. Since such transactions are not subject to VAT, the sellers cannot pass on any output VAT to the purchasers of goods, properties, or services, and they may not claim tax credit/refund of the input VAT they had paid thereon.

Section 103(q) of the Tax Code of 1977, as amended, cannot apply to transactions of respondent Toshiba because although the said section recognizes that transactions covered by special laws may be exempt from VAT, the very same section provides that those falling under Presidential Decree No. 66 are not. Presidential Decree No. 66, creating the Export Processing Zone Authority (EPZA), is the precursor of Rep. Act No. 7916, as amended,[20] under which the EPZA evolved into the PEZA. Consequently, the exception of Presidential Decree No. 66 from Section 103(q) of the Tax Code of 1977, as amended, extends likewise to Rep. Act No. 7916, as amended.

This Court agrees, however, that PEZA-registered enterprises, which would necessarily be located within ECOZONES, are VAT-exempt entities, not because of Section 24 of Rep. Act No. 7916, as amended, which imposes the five percent (5%) preferential tax rate on gross income of PEZA-registered enterprises, in lieu of all taxes; but, rather, because of Section 8 of the same statute which establishes the fiction that ECOZONES are foreign territory.

It is important to note herein that respondent Toshiba is located within an ECOZONE. An ECOZONE or a Special Economic Zone has been described as —

> . . . [S]elected areas with highly developed or which have the potential to be developed into agro-industrial, industrial, tourist, recreational, commercial, banking, investment and financial centers whose metes and bounds are fixed or delimited by Presidential Proclamations. An ECOZONE may contain any or all of the following:

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[20] *Commissioner of Internal Revenue v. Seagate Technology (Philippines), Ibid.*

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industrial estates (IEs), export processing zones (EPZs), free trade zones and tourist/recreational centers.[21]

The national territory of the Philippines outside of the proclaimed borders of the ECOZONE shall be referred to as the Customs Territory.[22]

Section 8 of Rep. Act No. 7916, as amended, mandates that the PEZA shall manage and operate the ECOZONES as a separate customs territory;[23] thus, creating the fiction that the ECOZONE is a foreign territory.[24] As a result, sales made by a supplier in the Customs Territory to a purchaser in the ECOZONE shall be treated as an exportation from the Customs Territory. Conversely, sales made by a supplier from the ECOZONE to a purchaser in the Customs Territory shall be considered as an importation into the Customs Territory.

Given the preceding discussion, what would be the VAT implication of sales made by a supplier from the Customs Territory to an ECOZONE enterprise?

The Philippine VAT system adheres to the Cross Border Doctrine, according to which, 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. Hence, actual export of goods and services from the Philippines to a foreign

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[21] Part I, Rule 1, Section 2(f) of the Implementing Rules and Regulations of Rep. Act No. 7916, as amended.

[22] Part I, Rule 1, Section 2(g) of the Implementing Rules and Regulations of Rep. Act No. 7916, as amended.

[23] Section 8 of Rep. Act No. 7916, as amended, reads in full –

SEC. 8. *ECOZONE to be Operated and Managed as Separate Customs Territory*. — The ECOZONES shall be managed and operated by the PEZA as separate customs territory.

The PEZA is hereby vested with the authority to issue certificates of origin for products manufactured or processed in each ECOZONE in accordance with the prevailing rules of origin, and the pertinent regulations of the Department of Trade and Industry and/or Department of Finance.

[24] VICTOR A. DEOFERIO, JR. AND VICTORINO C. MAMALATEO, *THE VALUE ADDED TAX IN THE PHILIPPINES*, p. 199 (2000 Ed.).

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country must be free of VAT; while, those destined for use or consumption within the Philippines shall be imposed with ten percent (10%) VAT.[25]

Applying said doctrine to the sale of goods, properties, and services to and from the ECOZONES,[26] the BIR issued Revenue Memorandum Circular (RMC) No. 74-99, on 15 October 1999. Of particular interest to the present Petition is Section 3 thereof, which reads —

SECTION 3. *Tax Treatment Of Sales Made By a VAT Registered Supplier from The Customs Territory, To a PEZA Registered Enterprise.* —

(1) If the Buyer is a PEZA registered enterprise which is subject to the 5% special tax regime, in lieu of all taxes, except real property tax, pursuant to R.A. No. 7916, as amended:

(a) *Sale of goods (i.e., merchandise).* — This shall be treated as indirect export hence, considered subject to zero percent (0%) VAT, pursuant to Sec. 106(A)(2)(a)(5), NIRC and Sec. 23 of R.A. No. 7916, in relation to ART. 77(2) of the Omnibus Investments Code.

(b) *Sale of service.* — This shall be treated subject to zero percent (0%) VAT under the ***"cross border doctrine"*** of the VAT System, pursuant to VAT Ruling No. 032-98 dated Nov. 5, 1998.

(2) If Buyer is a PEZA registered enterprise which is not embraced by the 5% special tax regime, hence, subject to taxes under the NIRC, *e.g.*, Service Establishments which are subject to taxes under the NIRC rather than the 5% special tax regime:

(a) *Sale of goods (i.e., merchandise).* — This shall be treated as indirect export hence, considered subject to zero percent (0%) VAT, pursuant to Sec. 106(A)(2)(a)(5), NIRC and Sec. 23 of R.A. No. 7916 in relation to ART. 77(2) of the Omnibus Investments Code.

(b) *Sale of Service.* — This shall be treated subject to zero percent (0%) VAT under the ***"cross border doctrine"*** of the VAT System, pursuant to VAT Ruling No. 032-98 dated Nov. 5, 1998.

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[25] Section 2, Revenue Memorandum Circular No. 74-99.

[26] Section 1, *Ibid*.

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(3) In the final analysis, any sale of goods, property or services made by a VAT registered supplier 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 actually qualified and thus legally entitled to the zero percent (0%) VAT. Accordingly, all sales of goods or property to such enterprise made by a VAT registered supplier from the Customs Territory shall be treated subject to 0% VAT, pursuant to Sec. 106(A)(2)(a)(5), NIRC, in relation to ART. 77(2) of the Omnibus Investments Code, while all sales of services to the said enterprises, made by VAT registered suppliers from the Customs Territory, shall be treated effectively subject to the 0% VAT, pursuant to Section 108(B)(3), NIRC, in relation to the provisions of R.A. No. 7916 and the "Cross Border Doctrine" of the VAT system.

This Circular shall serve as a sufficient basis to entitle such supplier of goods, property or services to the benefit of the zero percent (0%) VAT for sales made to the aforementioned ECOZONE enterprises and shall serve as sufficient compliance to the requirement for prior approval of zero-rating imposed by Revenue Regulations No. 7-95 effective as of the date of the issuance of this Circular.

Indubitably, no output VAT may be passed on to an ECOZONE enterprise since it is a VAT-exempt entity. The VAT treatment of sales to it, however, varies depending on whether the supplier from the Customs Territory is VAT-registered or not.

Sales of goods, properties and services by a VAT-registered supplier from the Customs Territory to an ECOZONE enterprise shall be treated as export sales. If such sales are made by a VAT-registered supplier, they shall be subject to VAT at zero percent (0%). In zero-rated transactions, the VAT-registered supplier shall not pass on any output VAT to the ECOZONE enterprise, and at the same time, shall be entitled to claim tax credit/refund of its input VAT attributable to such sales. Zero-rating of export sales primarily intends to benefit the exporter (*i.e.*, the supplier from the Customs Territory), who is directly and legally liable for the VAT, making it internationally competitive by allowing it to credit/refund the input VAT attributable to its export sales.

Meanwhile, sales to an ECOZONE enterprise made by a non-VAT or unregistered supplier would only be exempt from

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VAT and the supplier shall not be able to claim credit/refund of its input VAT.

Even conceding, however, that respondent Toshiba, as a PEZA-registered enterprise, is a VAT-exempt entity that could not have engaged in a VAT-taxable business, this Court still believes, given the particular circumstances of the present case, that it is entitled to a credit/refund of its input VAT.

II

Prior to RMC No. 74-99, however, PEZA-registered enterprises availing of the income tax holiday under Executive Order No. 226, as amended, were deemed subject to VAT.

In his Petition, petitioner CIR opposed the grant of tax credit/refund to respondent Toshiba, reasoning thus —

> In the first place, respondent could not have paid input taxes on its purchases of goods and services from VAT-registered suppliers because such purchases being zero-rated, that is, no output tax was paid by the suppliers, no input tax was shifted or passed on to respondent. The VAT is an indirect tax and the amount of tax may be shifted or passed on to the buyer, transferee or lessee of the goods, properties or services *(Section 105, 1997 Tax Code).*
>
> xxx xxx xxx
>
> Secondly, Section 4.100-2 of Revenue Regulations No. 7-95 provides:
>
> > "SEC. 4.100-2. *Zero-rated sales.* — A zero-rated sale by a VAT-registered person, which is a taxable transaction for VAT purposes, shall not result in any output tax. However, the input tax on his purchases of goods, properties or services related to such zero-rated sale shall be available as tax credit or refund in accordance with these regulations."
>
> From the foregoing, the VAT-registered person who can avail as tax credit or refund of the input tax on his purchases of goods, services or properties is the seller whose sale is zero-rated. Applying the foregoing provision to the case at bench, the VAT-registered supplier, whose sale of goods and services to respondent is zero-rated, can avail as tax credit or refund the input taxes on its (supplier) own

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purchases of goods and services related to its zero-rated sale of goods and services to respondent. On the other hand, respondent, as the buyer in such zero-rated sale of goods and services, could not have paid input taxes for which it can claim as tax credit or refund.[27]

Before anything else, this Court wishes to point out that petitioner CIR is working on the erroneous premise that respondent Toshiba is claiming tax credit or refund of input VAT based on Section 4.100-2,[28] in relation to Section 4.106-1(a),[29] of RR No. 7-95, as amended, which allows the tax credit/refund of input VAT on zero-rated sales of goods, properties or services. Instead, respondent Toshiba is basing its claim for tax credit or refund on Sec. 4.106-1(b) of the same regulations, which allows a VAT-registered person to apply for tax credit/refund of the input VAT on its capital goods. While in the former, the seller of the goods, properties or services is the one entitled to the tax credit/refund; in the latter, it is the purchaser of the capital goods.

Nevertheless, regardless of his mistake as to the basis for respondent Toshiba's application for tax credit/refund, petitioner

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[27] *Rollo,* pp. 21-22.

[28] According to Section 4.100-2, "A zero rated sale by a VAT-registered person, which is a taxable transaction for VAT purposes, shall not result in any output tax. However, the input tax on his purchases of goods, properties or services related to such zero-rated sale shall be available as tax credit or refund in accordance with these regulations."

[29] The full text of Section 4.106-1(a) is reproduced below —

Sec. 4.106-1. *Refunds or tax credits of input tax.* — (a) *Zero-rated sales of goods or properties or services.* — Only a VAT-registered person may be given a tax credit certificate or refund of VAT paid corresponding to the zero-rated sales of goods, properties or services, excluding the presumptive input tax and to the extent that such input tax has not been applied against the output tax. The application should be made within two (2) years after the close of the taxable quarter when the sales were made.

However, where the taxpayer is engaged in both zero-rated or effectively zero-rated sales and in taxable or exempt sales of goods, properties or services, and where the amount of creditable input tax due or paid cannot be directly and entirely attributable to any one of the transactions, only the proportionate share of input taxes allocated to zero-rated or effectively zero-rated sales can be refunded or issued a tax credit certificate.

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CIR validly raised the question of whether any output VAT was actually passed on to respondent Toshiba which it could claim as input VAT subject to credit/refund. If the VAT-registered supplier from the Customs Territory did not charge any output VAT to respondent Toshiba believing that it is exempt from VAT or it is subject to zero-rated VAT, then respondent Toshiba did not pay any input VAT on its purchase of capital goods and it could not claim any tax credit/refund thereof.

The rule that any sale by a VAT-registered supplier from the Customs Territory to a PEZA-registered enterprise shall be considered an export sale and subject to zero percent (0%) VAT was clearly established only on 15 October 1999, upon the issuance of RMC No. 74-99. Prior to the said date, however, whether or not a PEZA-registered enterprise was VAT-exempt depended on the type of fiscal incentives availed of by the said enterprise. This old rule on VAT-exemption or liability of PEZA-registered enterprises, followed by the BIR, also recognized and affirmed by the CTA, the Court of Appeals, and even this Court,[30] cannot be lightly disregarded considering the great number of PEZA-registered enterprises which did rely on it to determine its tax liabilities, as well as, its privileges.

According to the old rule, Section 23 of Rep. Act No. 7916, as amended, gives the PEZA-registered enterprise the option to choose between two sets of fiscal incentives: (a) The five percent (5%) preferential tax rate on its gross income under Rep. Act No. 7916, as amended; and (b) the income tax holiday provided under Executive Order No. 226, otherwise known as the Omnibus Investment Code of 1987, as amended.[31]

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[30] *Commissioner of Internal Revenue v. Cebu Toyo Corporation*, G.R. No. 149073, 16 February 2005.

[31] According to Section 23 of Rep. Act No. 7916, as amended, "Business establishments operating within the ECOZONES shall be entitled to the fiscal incentives as provided for under Presidential Decree No. 66, the law creating the Export Processing Zone Authority, or those provided under Book VI of Executive Order No. 226, otherwise known as the Omnibus Investment Code of 1987."

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The five percent (5%) preferential tax rate on gross income under Rep. Act No. 7916, as amended, is in lieu of all taxes. Except for real property taxes, no other national or local tax may be imposed on a PEZA-registered enterprise availing of this particular fiscal incentive, not even an indirect tax like VAT.

Alternatively, Book VI of Exec. Order No. 226, as amended, grants income tax holiday to registered pioneer and non-pioneer enterprises for six-year and four-year periods, respectively.[32] Those availing of this incentive are exempt only from income tax, but shall be subject to all other taxes, including the ten percent (10%) VAT.

This old rule clearly did not take into consideration the Cross Border Doctrine essential to the VAT system or the fiction of the ECOZONE as a foreign territory. It relied totally on the choice of fiscal incentives of the PEZA-registered enterprise. Again, for emphasis, the old VAT rule for PEZA-registered enterprises was based on their choice of fiscal incentives: (1) If the PEZA-registered enterprise chose the five percent (5%) preferential tax on its gross income, in lieu of all taxes, as provided by Rep. Act No. 7916, as amended, then it would be VAT-exempt; (2) If the PEZA-registered enterprise availed of the income tax holiday under Exec. Order No. 226, as amended, it shall be subject to VAT at ten percent (10%). Such distinction was abolished by RMC No. 74-99, which categorically declared that all sales of goods, properties, and services made by a VAT-registered supplier from the Customs Territory to an ECOZONE enterprise shall be subject to VAT, at zero percent (0%) rate, regardless of the latter's type or class of PEZA registration; and, thus, affirming the nature of a PEZA-registered or an ECOZONE enterprise as a VAT-exempt entity.

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[32] Article 39 of Exec. Order No. 226, as amended, reads in part as —

ART. 39. Incentives to Registered Enterprises. — All registered enterprises shall be granted the following incentives to the extent engaged to a preferred area of investment:

(a) Income Tax Holiday. —

(1) For six (6) years from commercial operation for pioneer firms and four (4) years for non-pioneer firms, new registered firms shall be fully exempt from income taxes levied by the National Government...

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The sale of capital goods by suppliers from the Customs Territory to respondent Toshiba in the present Petition took place during the first and second quarters of 1996, way before the issuance of RMC No. 74-99, and when the old rule was accepted and implemented by no less than the BIR itself. Since respondent Toshiba opted to avail itself of the income tax holiday under Exec. Order No. 226, as amended, then it was deemed subject to the ten percent (10%) VAT. It was very likely therefore that suppliers from the Customs Territory had passed on output VAT to respondent Toshiba, and the latter, thus, incurred input VAT. It bears emphasis that the CTA, with the help of SGV & Co., the independent accountant it commissioned to make a report, already thoroughly reviewed the evidence submitted by respondent Toshiba consisting of receipts, invoices, and vouchers, from its suppliers from the Customs Territory. Accordingly, this Court gives due respect to and adopts herein the CTA's findings that the suppliers of capital goods from the Customs Territory did pass on output VAT to respondent Toshiba and the amount of input VAT which respondent Toshiba could claim as credit/refund.

Moreover, in another circular, Revenue Memorandum Circular (RMC) No. 42-2003, issued on 15 July 2003, the BIR answered the following question —

Q-5: Under Revenue Memorandum Circular (RMC) No. 74-99, purchases by PEZA-registered firms automatically qualify as zero-rated without seeking prior approval from the BIR effective October 1999.

1) Will the OSS-DOF Center still accept applications from PEZA-registered claimants who were allegedly billed VAT by their suppliers before and during the effectivity of the RMC by issuing VAT invoices/receipts?

xxx xxx xxx

A-5(1): If the PEZA-registered enterprise is paying the 5% preferential tax in lieu of all other taxes, the said PEZA-registered taxpayer cannot claim TCC or refund for the VAT paid on purchases. However, if the taxpayer is availing of the income tax holiday, it can claim VAT credit provided:

a. The taxpayer-claimant is VAT-registered;

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b. Purchases are evidenced by VAT invoices or receipts, whichever is applicable, with shifted VAT to the purchaser prior to the implementation of RMC No. 74-99; and

c. The supplier issues a sworn statement under penalties of perjury that it shifted the VAT and declared the sales to the PEZA-registered purchaser as taxable sales in its VAT returns.

For invoices/receipts issued upon the effectivity of RMC No. 74-99, the claims for input VAT by PEZA-registered companies, regardless of the type or class of PEZA registration, should be denied.

Under RMC No. 42-2003, the DOF would still accept applications for tax credit/refund filed by PEZA-registered enterprises, availing of the income tax holiday, for input VAT on their purchases made prior to RMC No. 74-99. Acceptance of applications essentially implies processing and possible approval thereof depending on whether the given conditions are met. Respondent Toshiba's claim for tax credit/refund arose from the very same circumstances recognized by Q-5(1) and A-5(1) of RMC No. 42-2003. It therefore seems irrational and unreasonable for petitioner CIR to oppose respondent Toshiba's application for tax credit/refund of its input VAT, when such claim had already been determined and approved by the CTA after due hearing, and even affirmed by the Court of Appeals; while it could accept, process, and even approve applications filed by other similarly-situated PEZA-registered enterprises at the administrative level.

III

Findings of fact by the CTA are respected and adopted by this Court.

Finally, petitioner CIR, in a last desperate attempt to block respondent Toshiba's claim for tax credit/refund, challenges the allegation of said respondent that it availed of the income tax holiday under Exec. Order No. 226, as amended, rather than the five percent (5%) preferential tax rate under Rep. Act No. 7916, as amended. Undoubtedly, this is a factual matter that should have been raised and threshed out in the lower courts. Giving it credence would belie petitioner CIR's assertion that it is raising only issues of law in its Petition that may be

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resolved without need for reception of additional evidences. Once more, this Court respects and adopts the finding of the CTA, affirmed by the Court of Appeals, that respondent Toshiba had indeed availed of the income tax holiday under Exec. Order No. 226, as amended.

WHEREFORE, based on the foregoing, this Court *AFFIRMS* the decision of the Court of Appeals in CA-G.R. SP. No. 59106, and the order of the CTA in CTA Case No. 5593, ordering said petitioner CIR to refund or, in the alternative, to issue a tax credit certificate to respondent Toshiba, in the amount of ₱16,188,045.44, representing unutilized input VAT for the first and second quarters of 1996.

SO ORDERED.

Puno (Chairman), Austria-Martinez, Callejo, Sr., and *Tinga, JJ.,* concur.

SECOND DIVISION

[G.R. No. 152230. August 9, 2005]

JESUS IS LORD CHRISTIAN SCHOOL FOUNDATION, INC., *petitioner, vs.* **MUNICIPALITY (now CITY) OF PASIG, METRO MANILA,** *respondent.*

SYLLABUS

1. POLITICAL LAW; STATE; INHERENT POWERS; LOCAL GOVERNMENT CODE; EMINENT DOMAIN; NATURE AND SCOPE.— The right of eminent domain is usually understood to be an ultimate right of the sovereign power to appropriate any property within its territorial sovereignty for a public purpose. The nature and scope of such power has been comprehensively described as follows: … It is an indispensable attribute of sovereignty; a power grounded in the primary duty