

Headline	Despite the noble intention		
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Despite the noble intention

The Philippines, through certain laws administered by incentive-giving agencies, grants specific incentives to prospective investors in order to create a business environment that is investor-friendly. An example of these laws is Republic Act (RA) 7227, as amended by RA 9400 (or the law governing Clark Special Economic Zone and Clark Freeport Zone, among others), which granted freeport and economic zones (FEZs) registered entities with five percent tax on gross income earned in lieu of national and local taxes as well as tax and duty-free importation of goods and capital equipment.

Back in 2012, the Department of Finance issued Revenue Regulations (RR) 02-2012 in response to the reported rampant smuggling of petroleum and petroleum

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products resulting in substantial revenue losses to the government. The regulations required an upfront payment by the importer to the Bureau of Customs (BOC) of value-added tax (VAT) and excise tax on the importation of all petroleum and petroleum products that are imported and /or brought directly from abroad to the Philippines, including FEZs. The subsequent export or sale of these petroleum or petroleum products to registered enterprises enjoying tax privileges within the FEZs shall be subject to zero percent VAT.

Further, the regulations allowed the importer to file a claim for credit or refund of any VAT and excise tax previously paid with the BOC provided that the importer can prove that the said petroleum or petroleum

products have been sold to a duly registered enterprise enjoying tax privileges within the FEZs and used pursuant to the registered activity of such enterprise.

At first glance, RR 02-2012 appears to be a simple tax administrative measure with the noble intention of stop the alleged smuggling of petroleum and petroleum products through the special economic zones by ensuring that the correct taxes are paid and collected. However, the controversy surrounding this regulation arose from the question of whether it impliedly amended existing laws since FEZs are considered, by legal fiction, as foreign territories which enjoy special incentives including tax and duty-free importation of goods.

On the same year, Carmelo Lazatin, in his capacity as Pampanga first district representative, together with Ecozone Plastic Enterprises Corp., questioned the validity of RR 02-2012. They alleged that the imposition of VAT and excise tax under RR 02-2012 on the importation of petroleum and petroleum products into FEZs directly contravenes RA 7227, as amended by RA 9400. Moreover, RR 02-2012's mechanism of requiring FEZ enterprises to pay the tax first and to subsequently claim a credit or to refund the taxes paid effectively removes the enterprises' tax-exempt status.

On the other hand, the secretary of finance and the commissioner of internal revenue argued that the tax exemption granted to FEZ enterprises is a qualified tax exemption rather than automatic. Thus, the FEZ enterprises must first pay the corresponding taxes on their imported petroleum and petroleum products. Only upon showing that the condition for exemption under the law has been satisfied – that is, the importation must not be removed from the FEZ and introduced into the Philippine customs territory – may the importers claim a credit or refund of the taxes previously paid. Since the process allows for a refund, FEZ enterprises still, in effect, enjoy a tax exemption.

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On Nov. 29, 2016, the Supreme Court finally rendered a decision in the case of *Secretary of Finance Cesar Purisima and Commissioner of Internal Revenue Kim Jacinto-Henares vs. Representative Carmelo Lazatin and Ecozone Plastic Enterprises Corp., G.R. 210588*, declaring RR 02-2012 as invalid and unconstitutional because it illegally imposes taxes upon FEZ enterprises which, by law, enjoy tax-exempt status. It also effectively amends the RA 7227, as amended by RA 9400 and thereby encroaches upon the legislative authority reserved exclusively by the Constitution for Congress.

As explicitly stated under RA 9400 and its implementing rules, the FEZ shall be operated and managed as a separate customs territory to ensure free flow or movement of goods and capital equipment into, within and exported out of the FEZ, as well as provide incentives such as tax- and duty-free importation.

Unlike the importation of goods into the Philippine customs territory which is subject to Philippine tax and customs laws, the importation by the enterprises within the FEZ shall enjoy tax and duty-free importation status pursuant to RA 9400. This is consistent with the concept of "cross border doctrine" of the Philippine VAT system which means that no VAT shall be imposed to form part of the cost of the goods destined for consumption outside the Philippine customs territory. As previously mentioned, FEZs are considered, by legal fiction, as foreign territories. An FEZ enterprise cannot be directly charged for the VAT on its sales nor can VAT be passed on to them indirectly as added cost to their purchases. Thus, the VAT and excise tax imposed by RR 02-2012 directly violate these exemptions.

Further, the court ruled that the refund mechanism provided for under RR 2-2012 does not amount to a tax exemption. Even if the possibility of a subsequent refund exists, RR 02-2012 completely contradicts the essence of the tax exemption since the fact remains that FEZ enterprises must still spend money and other resources to pay for something they should be immune to in the first place. Also, the court did not agree with the view that FEZ enterprises have the duty to prove their entitlement to tax exemption first before fully enjoying the same. The exemption from local and national taxes granted under RA 7227, as amended by RA 9400 are automatically accorded to FEZs.

The court finally ruled that the issuance of RR 02-2012 illegally amended the law – a power solely vested on Congress.

While RR 02-2012 was issued with the noble intention of ensuring that VAT and excise tax on the importation of petroleum and petroleum products are properly collected, tax administration through executive issuances by the Department of Finance or the Bureau of Internal Revenue must be within the bounds of current laws enacted by Congress as it is a basic rule that regulations may not enlarge, alter, restrict, or otherwise go beyond the provisions of the law they administer.

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