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TAX LAW FOR BUSINESS

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Taxing oil in economic zones is illegal

SMUGGLING of petroleum products has been rampant in the last couple of years. The value-added tax (VAT) and excise-tax exemptions of free-port and economic zones (FEZs) are being abused by enterprising individuals.

To curtail this problem, the Bureau of Internal Revenue in 2012 required the payment of VAT and excise tax on the importation of petroleum coming directly from abroad and brought into the Philippines, including FEZs, by issuing Revenue Regulation (RR) 2-2012.

In the said RR, an FEZ locator must first pay the required taxes upon entry into the FEZ of a petroleum product and must, thereafter, prove the use of the petroleum product for the locator's registered activity in order to secure a refund for the taxes paid. In other words, the locator must first pay the tax and prove that it was used inside the FEZ before a refund may be made.

This government policy was opposed by the FEZ locators, and the Supreme Court (SC) has sided with them. RR 2-2012 was recently struck down as illegal and unconstitutional (GR 210588, November 29, 2016).

The SC upheld that by law, special areas are separate customs territories, i.e., the Clark FEZ and the Subic FEZ. In other words, they are foreign territories, by legal fiction. Thus, goods brought into and traded within an FEZ are generally not covered by internal-revenue taxes and customs duties enforced in the Philippine territory. This is consistent with the incentive granted to FEZs exempting the importation itself from taxes and duties. Therefore, according to the SC, the act of bringing the goods into an FEZ is not a taxable importation. As long as the goods remain in the FEZ or reexported to another foreign jurisdiction, they shall continue to be tax-free.

According to the SC, FEZ enterprises bringing goods into the FEZ should not be considered as importers subject to tax, in the same manner that the very act of bringing goods into these special territories does not make them taxable importations. The exemption from taxes and duties are granted not only to importations into the FEZ, but also specifically to each FEZ enterprise. When the law speaks of a tax exemption, it should be understood as freedom from the imposition and payment of a particular tax. Based on this premise, the Court ruled that the refund mechanism provided by RR 2-2012 does not amount to a tax exemption. Even if the possibility of a subsequent refund exists, the fact remains that FEZ enterprises must still spend money and other resources to pay for something they should be entitled to in the first place.

This ruling of the court is a celebration of the true nature and purpose of FEZs. It is a tax haven introduced to attract foreign investors.

It is recognized that smuggling is happening in the FEZs because of the VAT and excise-tax incentives available to goods that are brought to it. It is true that some petroleum products pass through the FEZs and are eventually sold outside the FEZ. But the manner to curtail smuggling is not by formulating an administrative scheme that is unconstitutional. The SC said RR 2-2012 is unconstitutional, since it does not even refer to a specific Tax Code provision it wishes to implement. While it says its purpose is to craft administration measures for the collection of VAT

and excise tax on the importation of petroleum and petroleum products, not once did it mention the pertinent chapters of the Tax Code on VAT and excise tax.

Smuggling must be solved through proper enforcement of the law and prayers, lots of it.

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